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# HEARING ON THE PROPOSED FISCAL YEAR 1995 BUDGET FOR THE SMALL BUSINESS ADMINIS- TRATION

Y 4. SM 1/2: S. HRG. 103-583

Hearing on the Proposed Fiscal Year...

## HEARING BEFORE THE COMMITTEE ON SMALL BUSINESS UNITED STATES SENATE ONE HUNDRED THIRD CONGRESS

SECOND SESSION

ON

HEARING ON THE PROPOSED FISCAL YEAR 1995 BUDGET FOR THE  
SMALL BUSINESS ADMINISTRATION

FEBRUARY 22, 1994



Committee on Small Business  
Administration

Small Business Administration  
U.S. Government Printing Office

Printed for the Committee on Small Business

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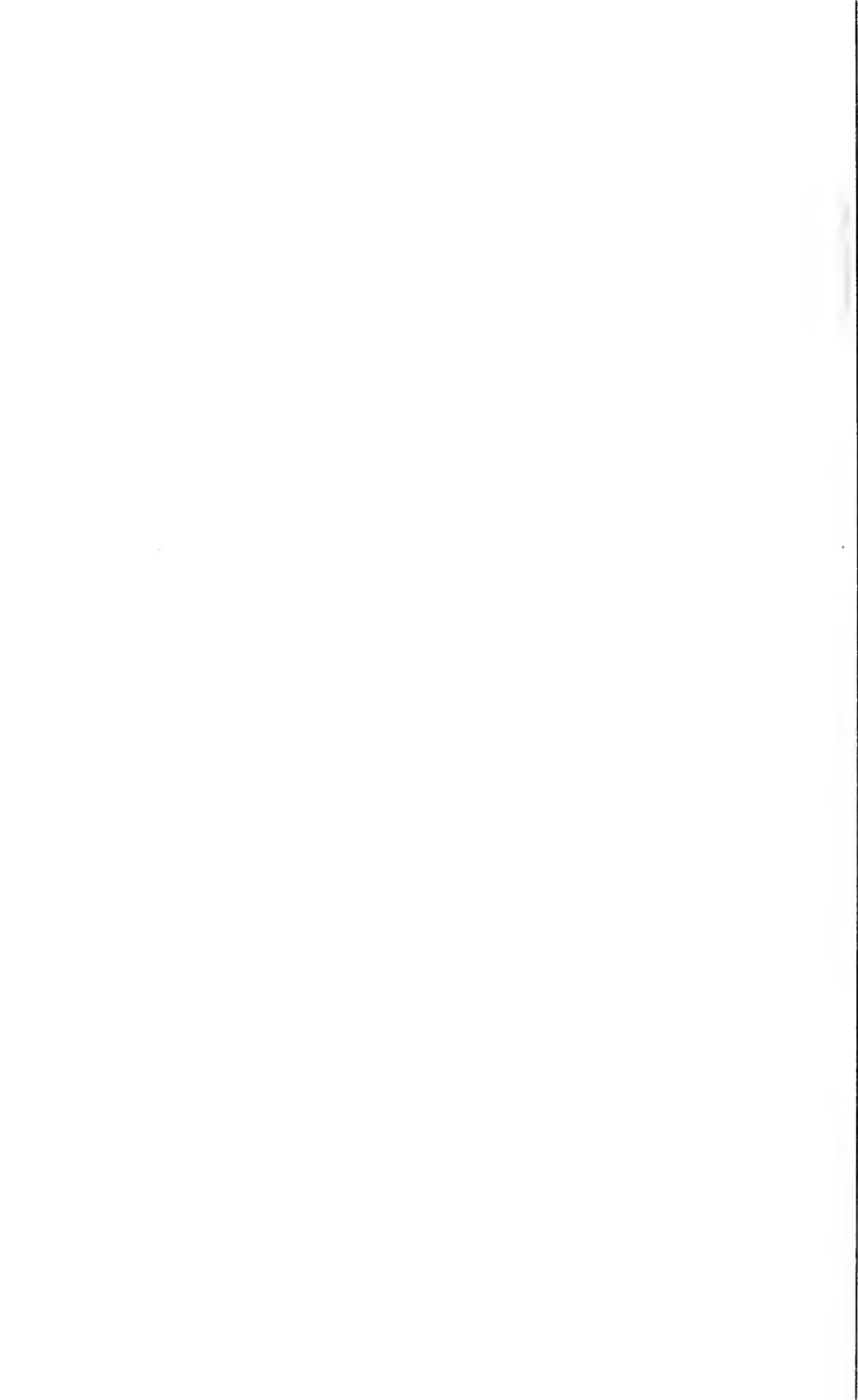
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# HEARING ON THE PROPOSED FISCAL YEAR 1995 BUDGET FOR THE SMALL BUSINESS AD- MINISTRATION

TUESDAY, FEBRUARY 22, 1994

U.S. SENATE,  
COMMITTEE ON SMALL BUSINESS,  
*Washington, DC.*

The Committee met, pursuant to notice, at 2:19 p.m. in Room SR-428A, Russell Senate Office Building, Hon. Dale Bumpers, Chairman, presiding.

## OPENING STATEMENT OF HON. DALE BUMPERS, A U.S. SENATOR FROM THE STATE OF ARKANSAS

The CHAIRMAN. The Committee today begins a series of hearings which will lead to a comprehensive reauthorization of Small Business Administration programs before the end of this year. We will begin by focusing on President Clinton's budget proposal for SBA, which was submitted two weeks ago.

First, it is clear that this budget is vastly different from those submitted to Congress for the last 12 years. Not only does it not propose to abolish SBA or any of its major programs, but in fact it proposes to retain last year's record high level of funding for the section 7(a) guaranteed bank loan program and to increase significantly two of SBA's other large lending programs, section 504 development company debentures and the SBIC lending and equity investment programs.

These increases total \$1.55 billion compared with fiscal year 1994 funding and these programs together would provide a total of \$11.65 billion in debt and equity capital for American small business if fully funded and implemented.

The Clinton Administration understands two economic realities which may seem paradoxical: One, that small business has been and continues to be the engine of our economic growth; and two, that small business' number one problem has been and remains the difficulty of finding adequate capital at an affordable cost to finance this continued growth and job creation.

I cannot tell my colleagues and the American people how gratifying it is, after many years in the wilderness, to have a President who understands basic economics, who believes that government can make a difference in the lives of our people and our economy, and who hires first-rate people who are capable of carrying out these programs.

This budget is not without some pain and sacrifice and there are portions which give me considerable doubt. On the whole, however, it is a vast improvement for almost every SBA program and for the beneficiaries of these programs.

I would also remind my colleagues that this budget would not have been possible if this Committee had not come together in a bipartisan fashion last summer and speedily enacted a truly landmark bill which cut the cost of the 7(a) program by more than half. Because of our efforts and those of our House colleagues, Administrator Bowles was able to go to the OMB and honestly say: We gave at the office.

Had we not already given more than a pound of flesh, we could not come close to funding program increases of the magnitude which are being proposed today.

I look forward to the testimony of Administrator Bowles and I will have a number of questions for him, as will my colleagues. I would remind Senators that the Administrator has a time constraint today and needs to leave before 4 p.m. His staff and program administrators can stay to answer any further questions if there are any.

Next week we will hold another hearing which focuses specifically on the status of SBA's 7(a) loan guarantee program and its future, as well as the all-important SBA disaster lending program, which has been needed all too frequently in recent years and months.

Mr. Bowles, we are always honored to have you with us and we look forward to hearing your testimony.

I am sorry, Senator Hutchison, that was not a deliberate slight. You are rather slight and I did not see you. Do you have an opening statement you would like to make?

Senator HUTCHISON. No, Mr. Chairman.

The CHAIRMAN. Thank you.

**STATEMENT OF HON. ERSKINE BOWLES, ADMINISTRATOR,  
SMALL BUSINESS ADMINISTRATION ACCOMPANIED BY: JOHN  
COX, ASSISTANT ADMINISTRATOR FOR FINANCIAL ASSISTANCE;  
GREG WALTER, ACTING COMPTROLLER; AND ARNOLD  
ROSENTHAL, DIRECTOR, OFFICE OF PLANNING AND BUDGET**

Mr. BOWLES. Thank you, Mr. Chairman. Mr. Chairman, I have with me today Arnie Rosenthal, who is Director of our Office of Planning and Budget; Greg Walter, who is our Deputy Comptroller; and John Cox, who is the Assistant Administrator for Financial Assistance.

If I could, I would like to request that my testimony be placed in its entirety into the record. Let me just, if I might, talk to you from a few notes that I made if that is okay and then take any questions that you have.

First of all, I do believe that we have accomplished a lot during our first nine months together as a team at the SBA, and I would like to stress that we are a team because I truly believe that is what we have become. This team has been assembled without regard to race, without regard to gender, and without regard to party affiliation. It is a team that truly is dedicated to helping



small businesses, dedicated to working together to reinvent the SBA so that it can truly become a more efficient, more effective, more user friendly organization.

Our accomplishments during our first nine months together center around, first, a reorganization plan which has truly been developed from the bottom up, a reorganization plan that truly will allow us to shift our assets to the field. As I have often said to you and to others, I subscribe to the management philosophy that you ought to put your assets where your customers are. Our customers are the owners of small businesses and they are in the field.

Since the beginning of 1993 and to the present time, we have been able to shift approximately 114 people out of Washington.

The CHAIRMAN. How many?

Mr. BOWLES. Approximately 114 out of Washington and approximately 334 out of our regions. Approximately 287 people have been added to our districts, resulting in an overall downsizing of employment of 161. From 1993 to 1995 we will be able to further expand the shift of our people to the field.

We have also held a series of eight town hall meetings where I have had a chance to listen to our customers, to hear their concerns and ideas, and then to report those back directly to the President. At these town hall meetings, I have met with over 2500 small business owners, over 400 lenders, and over 1,000 SBA employees. I was amazed to find out that many of those SBA employees had never before met an Administrator.

These meetings have had a big impact on our programs, as you will see from the list of items that I will cover that we have worked on so diligently during the last nine months. First of all, we have revised our 7(a) program, which you mentioned, Senator, taking over \$180 million of cost out of that program by reducing the subsidy rate and being able, at the same time, to generate a program that can fund up to \$8 billion worth of credit to the small business community.

For the first time in many, many years, an Administrator can live up to the promise that we did not have to come back to you for a supplemental appropriation for the 7(a) program. We do have enough money in that program.

Second, we have been able to take some of the bureaucracy out of our loan programs. I cannot tell you the number of small business owners I have met who have said over and over again that the paperwork involved in borrowing money from the SBA has historically been a nightmare. Senator, I hold before me an application for an \$18,000 loan from the SBA in San Antonio, TX, or I should say this was the application for an \$18,000 loan. This (indicating) is the application today. You truly can take the bureaucracy out of the government.

In addition to streamlining our programs and expanding our 7(a) program, we have also, as a response to our customers, developed a working capital line of credit program for our small business customers that truly will work. We have developed an export revolving line of credit program that truly will meet the needs of our small business customers. We have taken our SBIC program, which has truly been a troubled program, and we have brought in new

management from the outside. That is a program I feel we have well in hand.

In addition, in our 8(a) program, another troubled program at the SBA, we have been able to see where the problems are and come up with a recommended solution.

We have also laid the plans to accomplish much more. The SBA at long last finally has a real action plan, with real goals, real objectives, and real time lines, with real buy-in from our districts, real buy-in from our regions, and from the people in our central office.

This action plan is built around the following initiatives: First, we will develop several loan servicing centers by expanding our Fresno center to cover Regions 6 through 10; we will develop a new loan servicing center in Little Rock, Arkansas, to service Regions 1 through 5, and a loan processing center in Sacramento. This will allow us to operate more efficiently, more effectively, and at lower cost.

We will also expand our export assistance centers, which were begun in 1994. We opened up four of these in 1994 with the Commerce Department and the Eximbank and the SBA all being equal partners in these export assistance centers. We will open up ten more in 1995, at a cost of \$3.2 million.

In addition, we will develop one-stop capital shops within the empowerment zones and the enterprise centers, bringing together the SBA's management assistance programs along with its capital programs to truly meet the needs of those people in our poor rural communities and in our inner cities.

In addition to streamlining the SBA's forms with our LOWDOC program, we will also develop a Loan Express program. This will be a program where we will utilize the bank's own forms and operate with only a 50 percent guarantee.

We will also be able to bring forward this year our SBIC Participating Securities program, which we believe can go a long way toward re-invigorating the venture capital industry and really getting capital into the hands of new startup small businesses.

We will also put a renewed and additional emphasis on those areas that have clearly been starved for capital in the past. Those areas are in our poor rural communities, in our inner cities, and those small businesses that are owned by women and by minorities.

In addition, we will also focus on those small businesses that are creating the most jobs, where we can get our most bang for our buck by taking a dollar and putting it where it will create the largest number of jobs.

Lastly, we will bring to you the 8(a) reinvention program and our 8(a) program, which will focus on training, on business development and on greater access to capital.

I would now like to highlight for you some of the other aspects of our budget request. First of all, in the salaries and expense area we are requesting \$11.4 million fewer dollars for 1995 than we had in 1994. Our full-time equivalents, our authorized personnel, will drop from 3,814 to 3,741.

But do not be fooled by those numbers. Even though we are authorized in 1994 to have 3,814 people, we will not have that number of people at the SBA because we just flat cannot afford it.

We will only be able to fund 3,633 people, or 181 fewer people, because we have had to absorb \$5.1 million in 1994 for locality pay and the only way we could absorb that was by reducing our number of people.

We are authorized in 1995 for 3,741 people, but we will only be able to fund 3,616, or 125 fewer.

In our SBDC program, we are requesting \$67 million, which is less than the \$71.3 million we will have this year. We are doing that, not because we do not believe this is a good program, but simply we had to make some difficult choices in order to be able to do our part to reduce our Nation's budget.

The CHAIRMAN. Did you say SBDC?

Mr. BOWLES. SBDCs, yes, sir.

The SBI program is a program which historically has been funded at approximately \$3 million. We are not requesting any funds for the SBI program. Again this is a program that we believe has lots of merit, but we had to make some very difficult choices.

We are also requesting no money for the tree-planting program, which was an \$18 million program in 1994.

We are requesting additional appropriations for training in 1995. We have available about \$1 million for training in 1994. We are requesting \$4.2 million for training in 1995, and the reason is simple: We have not spent enough money in the last 12 years on training. As you know, the prior administrations wanted to get rid of the SBA, and when you have a very short-term focus you do not spend money on things that give you long-term benefits. Therefore, our people truly have not been trained and we need to spend some catch-up money to train our people and train them properly.

Lastly, in our surety bond program, we are requesting \$5.4 million versus \$7.0 million in 1994. In order to reduce our budget here and cut our expenses by \$2.4 million, we will change the operation of this program and go to a complete preferred program, which now makes up about 22 percent of our business.

This is a program we have been testing with the larger sureties in this country over the last couple of years. This preferred program will still allow us to extend about \$1.8 billion of surety bond guarantees to the small business owners of the country, but will allow us to reduce our expenses by about \$2.4 million and 49 full-time equivalents. It will reduce our administrative costs. It will result in faster approval for contractors and it will result in faster claim payments to sureties.

It is not without some sacrifice. But again, in our efforts to do our part to really manage this budget and hold our expenditures down, it is a tough decision we had to make.

We are requesting new fees of \$26.4 million. Absent these fees, we would need \$26.4 million of additional appropriations. These fees are in our SBDC program, and for our SBA publications. They are also loan modification fees as well as fees to use our electronic bulletin board.

In our business loan area, we are requesting appropriation of \$318.1 million to fund \$10.5 billion worth of business loans. We expect to have carryover authority of about \$38.5 million, which will give us an additional \$1.5 billion, taking up our total available

funding capacity for business loans in 1995 to \$11.9 billion. This compares to only \$8.4 billion in 1994 and \$7.4 in 1993.

We are not requesting any funding for our direct loan programs. In 1994, we expect to spend about \$13.5 million on direct loan programs exclusive of the microloan program. That \$13.5 million, because of the very high credit subsidy rate, will only allow us to put about \$50 million of direct loans out in the marketplace.

We can take that same \$13.5 million and we can put out \$496 million of loans if we do it on a guarantee basis. That is the reason we are recommending going to a guarantee basis as opposed to a direct basis. It gives the taxpayers a lot more bang for their buck.

In our 7(a) program, we are requesting \$207.1 million to fund the \$7.5 billion program. Again, with the carryover we will be able to fund up to \$9 billion worth of 7(a) loans.

In our 502 and 504 Development Company programs, we are requesting \$12.4 million to fund the \$2.1 billion programs. This is double the amount we did last year. We are very proud of these programs, where the taxpayers get their biggest bang for their buck. The Development Company programs have a weighted .58 percent credit subsidy rate.

It is also a very important program to our cities and our towns working on economic recovery and economic development because it provides long-term funds specifically to assist in economic development and reconstruction.

In our SBIC program, we are requesting \$90.6 million to fund \$730 million worth of program. The vast majority of the increase in this program is about \$500 million for the new Participating Securities Program which the Congress, in a very bipartisan manner, passed a couple of years ago.

The microloan program is a program that we are recommending to go from a direct program to a 100 percent guarantee program. We are requesting \$7.9 million to fund a \$65 million program, compared to an estimated \$27.5 million program in 1994.

The CHAIRMAN. Erskine, what were those figures again? It is going to cost us how much?

Mr. BOWLES. \$7.9 million to fund \$65 million worth of program.

The CHAIRMAN. If you go to the guaranteed loan?

Mr. BOWLES. Yes, sir. That is at a 12.16 percent credit subsidy rate.

In our disaster operations, I would like to first of all thank you very much for releasing the contingency funds and also for the supplemental appropriation that you gave our agency to work with the enormous disaster that we have in California now. Let me just give you a feel for the enormity of this disaster.

In the first 15 days of Hurricane Andrew, we had interviews for loans at the SBA of just under 19,000. In the first 15 days of the California earthquake we had interviews of just over 242,000 compared to 19,000.

In the first 15 days of this earthquake, we received over 19,000 applications for loans. Now, we have really shortened the forms, as you have known, and taken a lot of bureaucracy and a lot of paperwork out, so it is easier for someone to apply for a loan now. That 19,493 applications coming back compares to only 599 in the first 15 days of Hurricane Andrew.

To date we have had 314,000 interviews and have received over 56,000 applications for loans to the SBA. We now have 1,926 people on the ground in California. It is an enormous disaster.

We believe, thanks to the contingency funds that you released as well as the supplemental appropriation you passed, that we will end this year with approximately \$195 million, which will fund about \$849 million worth of program. At this time we believe that with the appropriation request we have made of \$52.5 million, that that will give us adequate funds to meet the needs of not only the carryover from the California earthquake, but the other normal disaster years, if there is such a thing any more, next year. And we believe that we can now do that without having the interest rate on the disaster loans raised to the Treasury rate plus one percent.

In the 503 program, as you know, Senators, this is a program that has, to say the least, a very onerous prepayment penalty. We are requesting \$30 million to help offset the onerous prepayment penalty contained in the 503 program. This \$30 million appropriation would be used to pay Treasury the differential between the 503 and 504 prepayment penalties.

In conclusion, we are requesting appropriations of \$806 million in 1995. That is \$402 million less than what was appropriated in 1993 and, as you say, that is while our business credit programs have grown from \$7.4 billion in 1993 to \$11.9 billion.

I will be happy to take your questions.

[The prepared statement of Mr. Bowles follows:]

**PREPARED STATEMENT OF ERSKINE BOWLES**

Mr. Chairman and distinguished members of this Committee, it is again a pleasure for me to appear before you. I believe that we are embarking on a very exciting period for small business, and I appreciate this opportunity to appear before you to discuss some of the Administration's plans for the SBA over the next few years. The President and I are committed to making great things happen for small businesses in our Country.

This Administration recognizes that small businesses are an important part of the overall effort to create and sustain a pattern of steady domestic economic growth and job creation. The President is firmly committed to helping small businesses start, prosper and grow. It is our goal to ensure that small businesses have the Federal assistance they need to play their part in sustaining the economic recovery. I am working side-by-side with the President to develop the SBA programs and plans to make this goal of sustained economic growth a reality during this Administration. Over the last year I traveled across the Country talking to over 2,500 small business owners and 400 small business lenders at town hall meetings in Atlanta, Cleveland, Des Moines, Hartford, Houston, Los Angeles and Portland. The President and I wanted to know what it is that the Federal Government can do--what programs and services can we refine or develop--to help these businesses survive, grow and prosper. We know that it is the products and services that small businesses create, along with the employment that activity implies, which are critical to the Nation's economic health. As you might expect, over and over again

I heard that small businesses lack access to capital to meet their basic business needs, whether that need involves commercializing an idea, purchasing inventory and equipment, or meeting a payroll. This was particularly true for those small businesses located in inner cities and poor rural communities, and those owned by minorities and women who need loans for amounts less than \$200,000.

Without that all-important capital, many businesses cannot survive; and clearly without capital, small businesses cannot grow and cannot create jobs -- it's as simple as that. And without these businesses we will not have a sustained and widespread economic recovery. It is therefore vitally important that we, the Administration and the Congress, work together to ensure this critical need is met through full funding of the 7(a) and other SBA loan programs and that these programs continue to be authorized under the Small Business Act at sufficient levels in FY 1995 and beyond. As you know, the current authorization for our appropriations in Section 20 of the Small Business Act will expire at the end of FY 1994. In addition, SBA's authority to enter into cosponsorships with the private sector and our authority for the Preferred Sureties program will also expire at the end of FY 1994. This reauthorization and other legislative actions will be forwarded to the Congress shortly as part of our FY 1995 Legislative Package.

The FY 1995 budget request for the SBA that has been sent to you by the President recommends \$11.9 billion in business lending for small businesses, including \$9.0 billion in 7(a) lending, \$2.1 billion in Development Company lending, \$730 million in Small Business Investment Company lending and \$65 million in Microloan lending. The \$9.0 billion for 7(a) lending is comprised of an FY 1995 request for \$7.5 billion plus \$1.5 billion that we project to be carried forward from FY 1994. Also included in this request is \$1.8 billion in new surety bond guarantees, and \$412 million for disaster lending.

#### REINVENTING/STREAMLINING THE SBA

Having spent the vast majority of my career in the private sector as a businessman, I understand the value of knowing your customers and their needs. But it is equally important to have the resources, programs, and delivery systems to meet those needs. To promote reinvention, streamlining, and empowerment at SBA, I actively sought ideas and suggestions from three sources: our primary constituents, small businesses; our partners, the lending institutions; and SBA employees, who meet our customers face-to-face every day. I wanted to find out what really needs to be done at the SBA to improve the way we deliver services and programs, and to reach out to those small businesses that have in the past been unwilling or unable to make use of SBA's services.



The first and most significant thing I learned was that we had too many staff dealing with things other than our small business customers. SBA's organizational structure had been established well before the advent of modern communications and information technologies. One of the benefits of these modern systems is the way they support leaner, more efficient organizational structures. Today's technologies make it possible to reduce administrative overhead. Modern organizations use these efficiencies to streamline their organizations, take cost out of their structure, and to put more assets in direct support of their customers, which is exactly what we want to do at SBA.

In reviewing our organization, it quickly became apparent that there was simply no longer a pressing need for ten large Regional Offices along with a large, highly segmented Headquarters staff to further oversee and monitor programs. We had too many staff focused internally, at the expense of our customers and their business needs.

To remedy this imbalance, I asked for advice from both our customers and our employees as to how they felt we could overhaul the SBA to give better customer service. Our management team took this advice and developed a reorganization proposal that would reduce administrative overhead, take advantage of current technologies, and put more of our employees in our District Offices dealing directly with our customers, the owners of small

businesses. This proposal was sent to you in late 1993 and I appreciate the support this committee has given. It is a tool that I urgently need to bring life to our plan for an effective SBA. The reorganization proposal includes several program initiatives that we plan to phase-in simultaneously over the next several months. The net effect of this reorganization will be positive and it will position SBA to better meet the future needs of our small business customers.

There are two initiatives that we will undertake immediately to improve the delivery of programs and services to our customers. First, we are proposing to downsize our Headquarters staff by about 150 employees through a combination of attrition and voluntary reassignments. Approximately 60 employees have opted for voluntary re-assignments to our District Offices, and about 45 of these people are already in their new locations, at the District Offices where SBA programs are delivered to our customers.

We expect to achieve the remaining reduction of 90 staff by the end of the fiscal year through attrition and retirements, with no adverse personnel actions. This reduction of 150 employees in Headquarters will allow us to turn back to GSA leased space for annual savings of almost \$1.5 million. Even more importantly we will have additional people in the field delivering services to our customers, the owners of small businesses.

Certain employment reductions have also been mandated as part of the overall Federal Government downsizing effort. Our FY 1995 budget request reflects the Administration's target Full-Time Equivalent (FTE) level of 3,845 for the SBA, which includes 104 for the Office of Inspector General. This is a reduction of 75 FTE's from our FY 1994 authorized ceiling of 3,920, which included 106 for Inspector General (IG).

Second, we are proposing to right-size our current system of regional offices to shift an additional 150 employees from our Regional Offices to our District Offices where, once again, they will take positions in support of our customer service efforts. In total, we hope to have over 210 additional employees working in our District Offices by early summer if our regional reorganization plan is approved. This influx of resources should help bolster our ability to deliver our expanding assistance programs such as the 7(a) loan program. This program has grown by some 120 percent since FY 1991, when we approved \$4.1 billion in loans. Our current request for 7(a) funding will support \$9.0 billion in FY 1995 loans.

#### SPECIAL INITIATIVES

In addition to shifting our employee base in support of customer service, we have taken a hard look inward at how we manage and administer our programs at the SBA. Over the past nine months,

with valuable input from our employees, our customers, and our partners at the lending institutions, we have developed a number of exciting new initiatives to improve the way we deliver our programs and services to our customers. I firmly believe that when these changes are in place and coupled with our additional field office employees, SBA will be better prepared to serve the needs of all sectors of the small business community in all parts of the Country.

Let me briefly summarize for you some of these initiatives.

#### LOAN SERVICING CENTERS

Among Federal agencies, SBA has been very successful in its loan collection operations, because of the highly automated and centralized approach we have adopted. This success has been demonstrated year after year in our four disaster home loan servicing centers in New York, Georgia, Texas, and California. In addition, our business loan servicing center in Fresno, California has also proven to be highly effective. To build on this proven efficiency, we plan to expand our California business loan servicing center and create an additional servicing center in Arkansas.

Over time, these servicing centers will assume the routine servicing and collection of most of our \$25 billion loan portfolio,

a portfolio that has grown dramatically over the past few years due to the large increase in our business and disaster loan programs. In fact, our portfolio was only about \$19 billion at the end of FY 1991. This centralization will improve our overall operations by bringing greater uniformity and lower transaction costs to more of our loan portfolio. With our Fresno servicing center we have experienced a 9 percent increase in the currency rate of SBA-serviced loans. We would expect similar results from this expansion effort. Also, this centralization of loan servicing will increase collections to the Government and thereby contribute to lower loan subsidy rates. Finally, through the economies of scale that these servicing centers create, we will free up human resources in our District Offices. We anticipate that we may be able to reduce portfolio servicing personnel nationwide by about 26 percent over time. Our employees will then be able to spend more time on resolving the difficult liquidation cases and assisting loan officers in delivering SBA's programs to the local small business community.

We are also proposing a similar centralization at the front end of our loan making operation to process 7(a) loan packages assembled by our preferred lenders. Again, we expect this effort to result in significant process efficiencies and greater levels of service to our customers.

**EXPORT ASSISTANCE CENTERS**

We are developing several "one-stop" shop concepts to provide small businesses information and services covering a range of Federal programs from a single site. In the International Trade area, we are jointly sponsoring four Export Assistance Centers in Baltimore, Los Angeles, Miami, and Chicago with the Department of Commerce and the Export-Import Bank. These locations were chosen to conform to the geographic concentration of international trade businesses and to be in close proximity to state and local export assistance resources. These centers will offer small businesses a wealth of information and assistance from the Federal, State, and Local levels. We are working on plans to expand the number of centers to fourteen in FY 1995, with a projection of eventually having sixty such centers throughout the country. Our budget request includes \$3.2 million to fund these fourteen centers in FY 1995.

**ONE-STOP CAPITAL SHOPS**

We realize that Federal economic recovery efforts must also address rural, inner-city, and economically depressed areas. Most of these areas have been under served by Federal small business assistance programs and services. Therefore, we plan to establish "One-Stop Capital Shops" within the Empowerment Zones and Enterprise Communities designated by Secretary Cisneros and Secretary Espy.

These centers will supply a comprehensive mix of Federal programs and services that are necessary to enable small businesses to start-up, survive and grow in these capital starved locations. We will work closely in this effort with our SCORE and SBDC resource partners. Our Minority Small Business Program, Small Business Investment Company Program, Certified Development Company Program, 7(a) Program, Microloan Program and Business Information Centers will all support this initiative to provide business development, lending, counseling, training and technical assistance at these locations. We hope to establish nine centers by next year and our FY 1995 budget request includes \$18.6 million to fund the program costs of these centers. Of this \$18.6 million, \$15.1 million will be used to fund \$375 million in financial assistance through our 7(a), Certified Development Companies (CDC), Small Business Investment Companies (SBIC), and Microloan programs.

#### SIMPLIFIED LOAN APPLICATION FORMS

Another of our initiatives is the recent development of a simplified loan application package for small businesses which need financing in an amount less than \$100,000. These loan applications are only one page long, and focus more on the applicant's character and history than on traditional credit criteria such as collateral. Lenders will be required to liquidate any loan under \$50,000. The reaction of small businesses to this program to date has been

overwhelmingly positive. Since this program was piloted in San Antonio, Texas in December, we have approved 147 loans for \$7.3 million. The program has brought many small lenders back to the small business market. The average loan size to date has been under \$50,000 and the average small business being lent to has only four employees. 18.3% of the loans have gone to women, and 23.8% to minorities. We are currently reviewing the pilot effort in Texas, and hope to roll-out this program to the rest of the Nation very shortly.

#### SBIC PARTICIPATING SECURITY

With respect to venture capital, we are finalizing our plans to introduce the Small Business Investment Company Participating Security program. I have recently added to our management team an acknowledged expert in the field of investment lending who will reinvigorate this program and manage it with the integrity and attention it demands. This new participating security has been long awaited by the SBIC and small business communities, because it will enhance the availability of urgently needed venture capital. As you know, most new small businesses do not need current pay capital. This program recognizes that fact and will enable SBICs to provide small business with financing structured in a manner that will allow the small businesses to get the capital they need and a chance to turn a profit before being burdened with debt repayment. Our FY 1995 budget request includes \$500 million in



financing to support this new program. We anticipate that over the next three years between 150-200 SBICs will be formed with \$10-\$15 million of equity capital each from the private sector. This \$1.5 to \$3.0 billion of private sector capital combined with the leverage provided by the SBA could result in up to \$9 billion being infused into building our economy and creating jobs.

#### RENEWED FINANCING EMPHASIS

We are also modernizing our traditional loan programs to make them more effective in meeting the capital needs of all small businesses. These revisions will include additional emphasis on those areas that have been previously under served by the SBA and are starved for capital including women-owned businesses, veteran-owned businesses, and minority-owned businesses as well as those areas creating the most job opportunities.

#### 8 (A) REVITALIZATION

We recognize the important role that minority businesses can play in the economic development and the revitalization of our economy.

Over the years, SBA's efforts to assist minority businesses have focused almost exclusively on companies interested in government contracting. We will expand the scope of the services

we provide to minority-owned businesses, working with our partners and sister agencies. Our program will make all of the programs and services offered by the Small Business Administration, including our finance programs, available to minority-owned businesses.

### FY 1995 BUDGET REQUEST

I would like to now highlight for you some of the important aspects of our FY 1995 budget request.

#### BUSINESS LOANS

For business loans, we have requested a subsidy appropriation of \$318.1 million to support \$11.9 billion in loans. We are not requesting funding for any direct loan programs. As you know, the subsidy rate for these direct loan programs is 10 to 15 times higher than that of our guaranty programs. To get maximum leverage from limited Federal appropriations, we have proposed only guaranty programs for FY 1995. We hope that with the introduction of the many changes we are proposing to our lending programs, the traditional need for direct loans will diminish. In addition, our staff believes there are few if any loans the SBA makes on a direct basis that would not be made on a guaranteed basis.

**7 (A) PROGRAM**

New subsidy appropriations for our popular 7(a) program are requested at \$207.1 million to fund a \$7.5 billion loan program, with an anticipated carry-over from FY 1994 of about \$38.5 million in subsidy budget authority to support a loan program of \$1.5 billion, for a combined FY 1995 program of \$9.0 billion. This program has grown from a FY 1991 level of \$4.1 billion, to \$5.6 billion in FY 1992, to \$6.4 billion in FY 1993, to a projected \$7.0 billion in FY 1994. This program carries a subsidy rate of 2.73 percent for FY 1995, compared with a 5.21 percent rate in FY 1993, and a 2.15 percent rate in FY 1994. The increase in the subsidy rate in FY 1995 is a result of technical reestimates and the inclusion of the empowerment zone initiative.

**7(a) GENERAL BUSINESS  
(Dollars in Millions)**

| Fiscal Year   | Subsidy Rate (%) | Subsidy Budget Authority | Program Level | Increase | % Change |
|---------------|------------------|--------------------------|---------------|----------|----------|
| 1992 Actual   | 4.85 %           | \$272.8                  | \$5,624.3     | \$ -     | - %      |
| 1993 Actual   | 5.21 1/          | 334.0                    | 6,409.9       | 785.6    | 14.0     |
| 1994 Estimate | 2.15             | 150.5 2/                 | 7,000.0 2/    | 590.1    | 9.2      |
| 1995 Request  | 2.73 3/          | 245.6 4/                 | 8,995.0 5/    | 1,995.0  | 28.5     |

1/Weighted average, includes subsidy rate of 5.47% for eleven months and 2.75% for one month

2/ Projected usage estimated at 12/1/93

3/ Includes .49% for reestimation of secondary market fees and .09% for impact of empowerment zone activity and economic assumptions

4/ Includes estimated carryover of subsidy budget authority of \$38.5 million and \$7.3 million for empowerment lending

5/ Includes estimated carryover in program level of \$1.45 billion and empowerment zone estimate of \$268 million

DEVELOPMENT COMPANY PROGRAM

Appropriations for the Development Company programs (502 and 504) are requested at \$12.4 million. This includes \$11.6 million in subsidy budget authority to fund a \$2.1 billion 504 program and \$.8 million in subsidy budget authority to fund a \$50 million 502 program. This is another program where demand has dramatically increased over the past few years. Approvals in FY 1991 were \$475 million, \$655 million in FY 1992, and \$852 million in FY 1993. Our FY 1994 appropriated level is \$1.0 billion, and at the current rate of approvals that level may not be sufficient this year. This program is becoming increasingly popular and important for cities and towns working on economic recovery, because it provides long-term loans specifically to assist in economic development and reconstruction. This program carries a subsidy rate of only .56 percent for FY 1995, compared with a .54 percent rate in FY 1993, and a .51 percent rate in FY 1994. The increase in FY 1995 is a result of technical reestimates and the inclusion of the empowerment zone initiative.

**DEVELOPMENT COMPANY**  
(Dollars in Millions)

| Fiscal Year   | Wgt Ave<br>Subsidy Rate<br>(%) | Subsidy<br>Budget<br>Authority | Program<br>Level | Increase | % Change |
|---------------|--------------------------------|--------------------------------|------------------|----------|----------|
| 1992 Actual   | 0.76 %                         | \$5.0                          | \$655.3          | \$ -     | - %      |
| 1993 Actual   | 0.76                           | 6.5                            | 852.1            | 196.8    | 30.0     |
| 1994 Estimate | 0.54                           | 5.7                            | 1,040.0          | 187.9    | 22.0     |
| 1995 Request  | 0.58                           | 12.4 1/                        | 2,128.9 2/       | 1,088.9  | 104.7    |

1/ Includes empowerment zone estimate of \$4 million in subsidy budget authority

2/ Includes empowerment zone estimate of \$72 million in program level

**SBIC PROGRAM**

The Small Business Investment Company (SBIC) Program is an important source of equity and subordinated debt financing for small businesses. Government funds supplement private capital in independent venture capital investment companies. During the past year, this program has been strengthened by the addition of experienced management and the development of a new participating security, which will allow SBICs to secure "patient" capital to match their long term venture investments. Title IV of P.L. 102-366, Small Business Credit and Business Opportunity Enhancement Act of 1992, when implemented will significantly increase the flow of private capital into the program.

For FY 1995, we are requesting \$730 million in program level for the SBIC Program, including \$500 million for the participating security at a subsidy rate of 8.99%, and \$230 million for debentures, at a subsidy rate of 15.99% for regular SBICs and

29.59% for specialized SBICs. Of this total, \$165 million will be available to regular SBICs, up from \$100 million in FY 1994, and \$65 million to the specialized SBICs, up from \$17.9 million in FY 1994, which invest only in businesses owned by persons who are socially or economically disadvantaged.

**SBIC PROGRAM**  
(Dollars in Millions)

| Fiscal Year   | Regular SBIC     |                          |               | Specialized SBIC |                          |               |
|---------------|------------------|--------------------------|---------------|------------------|--------------------------|---------------|
|               | Subsidy Rate (%) | Subsidy Budget Authority | Program Level | Subsidy Rate (%) | Subsidy Budget Authority | Program Level |
| 1992 Actual   | 14.29 %          | \$8.6                    | \$60.1        | 27.30 %          | \$3.4                    | \$12.3        |
| 1993 Actual   | 15.40            | 9.8                      | 63.4          | 28.88            | 3.2                      | 11.0          |
| 1994 Estimate | 11.36 1          | 35.0                     | 307.8 2       | 29.92            | 5.3                      | 17.9          |
| 1995 Request  | 10.73 3          | 71.4 4                   | 665.2 5<br>8  | 29.59            | 19.2 6                   | 65.0 7        |

- (1) Subsidy rate is a blended rate of 9.00% for Participating Securities and 16.25% for subordinated debentures
- (2) Includes \$207.8 million in program level for Participating Securities.
- (3) Subsidy rate is a blended rate of 8.99% for Participating Securities and 15.99% for subordinated debentures
- (4) Includes \$2.4 million in subsidy budget authority for Empowerment Zone
- (5) Includes \$15 million in program level for Empowerment Zone
- (6) Includes \$4.4 million in subsidy budget authority for Empowerment Zone
- (7) Includes \$15 million in program level for Empowerment Zone
- (8) Includes \$165.2 million of debentures and \$500 million of Participating Securities

**MICROLOAN PROGRAM**

We are requesting that the Microloan program be converted to a 100 percent guaranty program in FY 1995, and funded at \$7.9 million to provide a \$65 million loan program. Approvals in this program were \$13 million in FY 1992, and \$22 million in FY 1993. Our FY 1994 program level, including amounts carried-forward from FY 1993 is \$87 million. The subsidy rate for this program is 12.16 percent for FY 1995.

**MICROLOANS  
(Dollars in Millions)**

| Fiscal Year                | Subsidy Rate (%) | Subsidy Budget Authority | Program Level      | Increase | % Change |
|----------------------------|------------------|--------------------------|--------------------|----------|----------|
| 1992 Actual                | 17.33 %          | \$2.2                    | \$12.7             | \$ -     | - %      |
| 1993 Actual                | 15.95            | 3.6                      | 22.4               | 9.7      | 76.4     |
| 1994 Estimate              | 10.15            | 2.8 <sup>1/</sup>        | 27.5 <sup>1/</sup> | 5.1      | 22.8     |
| 1995 Request <sup>2/</sup> | 12.16            | 7.9 <sup>3/</sup>        | 65.0 <sup>4/</sup> | 37.5     | 136.4    |

1 Estimate of actual FY 94 usage as of 1/94.

2 Request to convert from a direct program to a guarantee program

3 In addition, \$5.4 million would be available as carry forward subsidy B A if Congress allows us to transfer from the existing direct program to the newly created guarantee program

4 In addition, \$44.2 million would be available as carry forward program level if Congress allows us to transfer from the existing direct program to the newly created guarantee program

DISASTER OPERATIONS (SALARIES AND EXPENSES AND LOANS)

I would like to take a few minutes to provide you an update on our response efforts to the Northridge California Earthquake. As you are aware, the SBA is again a major player in the Federal response effort to the recent disaster activity in North Ridge California. The President has taken a particularly personal interest in assuring that this response effort is the best that it can be, and I have assured him that I will do whatever it takes at the SBA to do our part. Therefore, I have traveled several times to California to review our operations there and to coordinate our efforts with the other Agencies and response teams. We are watching the volume of activity from this disaster grow daily. It truly appears to be the biggest disaster that the SBA has had to respond to in a long time, and maybe the largest ever in our 40 year history.

Four weeks after the California disaster we have conducted 297,000 interviews and received 43,000 applications. This compares to 116,000 interviews conducted and 41,000 applications received 18 months after the Hurricane Andrew disaster. Also, we have already approved 2,765 loans for \$86 million. We have a disaster response team of about 1,950 employees now primarily working out of Los Angeles and our Disaster Area 4 Office in Sacramento to provide the assistance that is needed.

I would also like to take this opportunity to thank you personally for your quick response in addressing our funding needs



through the release of our contingency funds and the provision of supplemental appropriations. These additional funds were critical to our ability to respond as timely and in such force as we have, yet enable us to take care of the many much smaller disasters that still require our attention and support.

With the release of the contingency funds and the supplemental appropriation that was provided, we now have available \$105 million to support the administrative costs of the California disaster and \$1.5 billion in loans. This is in addition to the \$97.7 million for administrative costs and \$817 million for loans that we have available for other disaster support activities. Also, there remains \$75 million in loan contingency budget authority representing another \$226 million in program level that can be released, if needed.

**DISASTER ASSISTANCE**  
**(Dollars in Millions)**

| Fiscal Year   | Subsidy Rate (%) | Subsidy Budget Authority | Program Level | Increase  | % Change | Salaries & Expense |
|---------------|------------------|--------------------------|---------------|-----------|----------|--------------------|
| 1992 Actual   | 33.93 %          | \$265.3                  | \$781.7       | \$ -      | - %      | \$59.4             |
| 1993 Actual   | 20.58            | 291.9                    | 1,418.6       | 636.9     | 81.5     | 109.7              |
| 1994 Estimate | 22.99            | 607.7 1/                 | 2,642.8 2/    | 1,224.2   | 86.3     | 162.7              |
| 1995 Request  | 12.67 3/         | 52.2                     | 411.6         | (2,231.2) | (84.4)   | 20.5 4/            |

1 Includes carryover of \$132.8 million, released contingency of \$145.0 million, \$75.0 million contingency not activated and \$254.75 million supplemental

2 Includes carryover of \$577.8 million, released contingency of \$630.7 million, \$326.2 million contingency not activated and \$1.108 billion supplemental

3 Includes proposal to increase interest rate

4 In addition, it is estimated that \$40.0 million will be carried forward from FY 1994 with \$20.0 million needed to support the L.A. quake

Now, I'd like to outline for you our FY 1995 request for the disaster program. We have requested \$20.5 million for the administrative costs of this operation in FY 1995. This estimate assumes that we will have sufficient carry-forward funds from FY 1994 under our existing contingencies. We expended \$110 million in disaster salaries and expenses in FY 1993 and are anticipating expending about \$163 million in FY 1994, barring any additional major disaster activity.

We have also requested a subsidy appropriation of \$52.2 million for the disaster loan program that will provide for a FY 1995 disaster loan level of \$412 million. This program carries a subsidy rate of 12.67 percent for FY 1995, compared to the FY 1994 subsidy rate of 22.99 percent. The increase in the subsidy rate is a result of technical reestimates, and our legislative proposal to increase the interest rate to the Treasury market rate plus one percent (estimated to be 6.93%). Approvals in this program were \$381 million in FY 1991, \$782 million in FY 1992, and \$1.4 billion in FY 1993. We estimate that with the California Earthquake, our FY 1994 approvals could reach \$1.8 billion. We also anticipate that an additional \$300 million in approvals from the California Earthquake will occur in FY 1995.

To support the ten-year average loan program level of \$412 and to maintain our disaster loan servicing operations, we would require approximately \$60 million in salaries and expenses funding for FY 1995. Of the \$202.7 million currently available

for salaries and expenses in FY 1994, we project that we may carry forward as much as \$40 million into FY 1995.

#### SURETY BOND PROGRAM

We have requested an appropriation of \$5.4 million for the Surety Bond program. This request will support a program level of \$1.8 billion in new bond approvals. As you know, the surety bond program remains one of our most popular programs and has a historically low loss rate of about 2 percent, thereby enabling a significant leveraging of Federal funds. Approvals in this program were \$1.1 billion in FY 1991, \$1.0 billion in FY 1992, and \$1.0 billion in FY 1993. Our FY 1994 appropriated level is \$1.8 billion. This program does not come under Federal Credit Reform, and therefore, has no subsidy rate attached to it.

In addition, we have significantly reduced the funding required for our Office of Surety Guarantees because we anticipate this program will be operated far differently in FY 1995. We anticipate converting 100% of the Surety program to our preferred program which now makes up 22% of our surety business. Such a conversion will still allow us to extend \$1.8 billion of surety bond guarantees to the small business community while reducing our cost by \$2.2 million and our surety personnel by 49 FTE's. This restructuring of the surety program will mean that we will no longer underwrite bond approvals or process claims and recoveries. This action will greatly reduce the administrative

costs to the SBA, result in faster approvals for the contractors, and faster claim payments to the sureties.

#### MINORITY BUSINESS DEVELOPMENT

As I mentioned earlier, we are taking an aggressive "ground-up" approach in assessing the objectives of our Minority Small Business program. In the coming weeks we will be proposing a legislative package to you that outlines our proposals for this program. We are very excited about these proposed changes and we see them as a workable solution to a program area that has not been effective in meeting the needs of our minority and disadvantaged small business customers.

The request is \$23.32 million for the Office of Minority Small Business, and, in addition, there is also \$500 thousand requested to complete the long delayed automation initiatives for the Minority Small Business program.

#### PROCUREMENT ASSISTANCE

The budget request for the Office of Procurement Assistance is \$16.4 million. This office ensures that small businesses receive a fair share of government procurement opportunities. This is done through the on-site location of procurement center representatives at major government installations and through the continuous monitoring of government contracting and subcontracting activities, and through the negotiation of

procurement goals with other agencies. Additionally, the office manages the procurement automated source system (PASS), which contains data on the capabilities of 222,000 small firms interested in doing business with the government. This data is used by hundreds of Federal procurement officials and large prime contractors to find qualified small businesses. The office also issues Certificates of Competency (COC), which document a firm's ability to successfully perform on government contracts.

#### BUSINESS DEVELOPMENT PROGRAMS

The SBDC program is requested at \$67 million. This program is designed to assist small businesses by linking federal, state, and local governments and the private sector to provide management and technical assistance to the small business community. The SBDC program currently has a network of 56 lead SBDCs located in 49 states and approximately 868 subcenters and satellite locations.

As I previously mentioned, we have requested \$3.2 million to support the four existing Export Assistance Centers and the ten additional centers proposed for FY 1995. We have also requested \$18.7 million for the nine "One-Stop Capital Shops" within the Empowerment Zones, including \$15.1 million to support \$375 million in financial assistance programs, \$1.1 million for Microloan technical grants, \$720 thousand for Business Information Centers, and \$1.7 million for project management.

We have included \$3.2 million in additional funding for staff training, which has long been neglected in this Agency. With fewer people, we have to train our people properly so we can be more productive. We currently have a portfolio of over \$25 billion in loans. This large portfolio of loans combined with the level of customer service that is necessary at the SBA will require skillfully trained and competent staff in all of our offices. Included in this training request are \$1.7 million for Economic Development programs training, \$500 thousand for Minority Enterprise Development training and \$1.0 million for centralized training in support of our other Agency program areas.

We are not seeking funding in the FY 1995 budget for any unauthorized initiatives, nor for the Small Business Institute program or the Tree Planting program.

**REGULAR SALARIES AND EXPENSES-LOCALITY PAY AND PAY INCREASES**

This budget request is consistent with the President's overall administrative and spending reductions, and will provide SBA with the resources necessary to deliver and administer our programs and services under our proposed streamlined organizational structure. The FY 1995 Salaries and Expenses funding request is for \$418.3 million and an FTE level of 3,741, excluding the Office of the Inspector General, whose budget request is separately included.

503 PREPAYMENT PENALTY

As you know, our 503 Development Company debenture borrowers have been unable to take advantage of reductions in the interest rates over the past few years due to the exorbitant prepayment penalty associated with early redemption of 503 debentures. Our FY 1995 budget request includes \$30 million in appropriations to help offset these penalties imposed on the borrowers. The prepayment program would allow high interest 503 borrowers to redeem or refinance their debentures as if they had borrowed under our 504 program using the same prepayment penalty that is in the 504 loan agreement. The associated penalty, which would go to the Treasury as an interest differential, would be forwarded by the SBA from this appropriation.

NEW FEE INITIATIVES

This budget request includes four specific fee initiatives proposed to assist the Federal appropriations process by generating \$26.4 million in revenues to the SBA. Absent these fees, an additional appropriation of \$26.4 million would need to be provided to fund the requested program levels and initiatives.

First, we propose to establish a \$15 per hour fee for counseling SBDC customers. We estimate this will generate \$17 million in revenues in FY 1995. We believe that this proposed fee is not only reasonable in view of the valuable services that SBDC counselors provide, we also believe that it will cause small business owners to use this program more wisely. We would also note that this fee is well below private sector market rates for similar services.

Second, we propose to charge a fee for all business development publications distributed by the SBA. These charges would range from about \$.50 to \$1.50, and would be used to offset the cost of printing, mailing, and distribution. We estimate generating \$1.15 million in revenues from this fee in FY 1995. Again, we believe that this minimal charge is reasonable, and below prevailing market rates considering the value of the product.

Third, we propose to charge a fee to our loan recipients who request changes to the terms and conditions of their loans. These changes are a routine part of servicing loans, and are widely



accepted in the commercial banking arena. Some typical instances in which we propose to charge this fee include: filing liens, subordinations, change of guarantors, and substitutions of collateral. A typical fee for executing such changes would be about \$75, which we estimate would generate \$7.2 million in revenues to the SBA in FY 1995. These fees would be collected through our participating lenders, and remitted to the SBA.

The final fee involves charging users for certain optional features on the Agency's first computer-based electronic bulletin board. This service (SBA On-Line) provides immediate, around-the-clock access to information on SBA's services, publications and programs, and users access through electronic gateways to other bulletin boards that contain information important to small businesses. The current 1-800 number was provided to SBA at no cost for the first year only. Due to the overwhelming response to this service (almost 800,000 calls since last year), the 1-800 number in FY 1995 will only be provided for initial access to SBA's general information. Users who wish to access other bulletin boards through the electronic gateways or who want to post and receive messages, will be assessed a user fee. This fee is expected to generate \$1 million in revenues to offset the expected \$1.5 million cost of providing this service. The Agency is planning to charge an average annual user fee of about \$35, which is approximately one-fourth of comparable commercial rates for similar services.

This concludes my summary of our FY 1995 budget request and some of the significant initiatives that we will be undertaking at the SEA over the next year or so. I would be happy to answer any questions that you may have for me.

The CHAIRMAN. Mr. Bowles, that is a very good, comprehensive statement. Let me ask you some things that are very much on my mind.

One is the thing that you concluded with, and that is the \$30 million you are asking for for the prepayment penalties of a lot of high interest 503 loans. I agree with that. In this day and time, it is a travesty. I know that those people agreed to those prepayment penalties.

We have the same thing in the REA program, which you may or may not be familiar with. It costs an awful lot more. There are about eight big REA cooperatives in this country that are saddled with tremendous prepayment penalties. Most of them want to pay their loans off because they run anywhere from 9 to 12 percent, and REA has been very recalcitrant.

We have tried to get some legislation through here, but, as you know, we have to find the money to do that.

Now, I am going to do my very best to come up with this \$30 million, because the idea of these small business people out there having to pay—how much? At what are most of these loans?

Mr. BOWLES. The interest rates range as high as 16 percent.

The CHAIRMAN. 16?

Mr. BOWLES. Yes, sir.

The CHAIRMAN. See, that is just a tragedy. We cannot sit here and pretend to be trying to help small business when we allow some guy to be threatened with closing his doors because of an interest rate like that.

Mr. BOWLES. And all we are recommending, Senator, is that the prepayment penalty be made similar to a market rate prepayment penalty that you would see in the private sector or the prepayment penalty that is very similar to our 504 prepayment penalty that is in existence today.

The CHAIRMAN. So there is a prepayment penalty. Now, that is the reason you are asking for \$30 million instead of the roughly \$160 million OMB said it would cost if we allowed them to refinance the whole thing, is that correct?

Mr. BOWLES. There are a couple of reasons for that. There are currently \$583 million worth of these 503 loans outstanding.

The CHAIRMAN. How many?

Mr. BOWLES. \$583 million. The number of loans is about 3,618, and the cost to us if all of them prepaid using 504 prepayment penalty would be about \$163 million. However, we do not expect that all of them would prepay. We do not expect that for a couple of reasons.

First of all, the 503 borrowers did a survey among themselves and their best estimate was that about 20 percent of those people would either choose to prepay or afford to be able to prepay. Just as with our 7(a) loan or our 504 loan, not everyone can financially afford to prepay.

In addition, it is usually those that have the highest interest rates that would choose the prepayment. If you make some kind of reasonable assumptions you can come up with a scenario where \$30 million would be enough to handle all of the need of all of the people who would be able to prepay in 1995.

The CHAIRMAN. As you know, Senator Hatfield has a bill pending that would authorize \$160 million for this purpose.

Second, let me say that someone came up to me in an airport the other day or on an airplane—I forgot where it was; it was someplace in Texas—and told me that this one-page SBA loan application is wonderful. I want to complement you on that. If you can make that work, you are going to win a Nobel Prize for something. If you can cut the application for an SBA loan on the order of magnitude which you are showing there, to one page, you are entitled to all the recognition that I or anybody else can get you.

But this woman came up to me and she said that this is presently a pilot program in the Dallas office. Is that correct?

Mr. BOWLES. It started out as a pilot program in the Dallas and in the San Antonio office.

The CHAIRMAN. That is where it was. I was in San Antonio.

Mr. BOWLES. We now have it spread throughout Texas, Louisiana, Arkansas, New Mexico, and Oklahoma. Senator Hutchison, it has been a phenomenal success. We have had small banks that have not used the SBA in years turn to us. We have small borrowers that have not come to the SBA.

The average size loan we are making with this single page application is about \$47,000. The average size business has four or fewer employees. About 25 percent are going to women-owned businesses. It really has been very successful.

Senator HUTCHISON. Mr. Chairman, could I speak out of order for just a minute to respond?

The CHAIRMAN. Sure.

Senator HUTCHISON. When I was State Treasurer of Texas, I worked with the SBA in the Texas offices on this pilot project and it is dynamite. The small business people in my State really do feel that difference. So I do compliment you for continuing that and improving and expanding on it.

The CHAIRMAN. Thank you, Senator Hutchison.

Now, on locality pay, you said that you were going to have to eat \$7 million on locality pay. I noticed the President did not ask anything for locality pay, or at least I did not see it.

Mr. BOWLES. It is not in the budget request.

The CHAIRMAN. Well, it is in there, but we are going to have to find it; is that the deal?

Mr. BOWLES. We have to eat in 1995 \$6.8 million worth of locality pay. The only way we can eat it is truly to cut into the number of people that we have at the SBA, and therefore we will have 125 fewer people in 1995 than we are authorized to have in order to make up for the \$6.8 million. And we will do that through attrition.

The CHAIRMAN. How would you feel about abolishing those specialized SBIC's? That is a fairly small program now, is it not?

Mr. BOWLES. Yes, sir, it is a relatively small program when compared to the SBIC program in total. But I would not be in favor of abolishing them.

The CHAIRMAN. How much money are you asking for that this year?

Mr. BOWLES. I think we are asking about \$65 million.

The CHAIRMAN. \$65 million?

Mr. BOWLES. In program dollars. About \$19 million in subsidy dollars. It is not a large program. Again, what needs to be corrected with the specialized SBIC program is how we define "socially or economically disadvantaged." That is where the problem lies.

Right now almost anything, it appears, can qualify as socially or economically disadvantaged. What we have to do is define that very narrowly so it really does meet the intent of the Congress, I believe.

The CHAIRMAN. Do you favor my proposal for a change in the bankruptcy rules for SBICs?

Mr. BOWLES. Yes, sir.

The CHAIRMAN. That would prohibit them from taking bankruptcy.

Mr. BOWLES. Yes, sir. We have long favored that position.

The CHAIRMAN. Well, I am going to make a run at it this year but I do not know. We might be able to get it done in the Senate. The House is another matter. I would have to look to you to help us over there, of course.

Mr. BOWLES. We will be glad to help you, because right now when they get in trouble they just declare bankruptcy and, since we are a subordinated lender, they just lock up the assets ahead of us.

The CHAIRMAN. I have a few other questions. I want to just ask one and I will defer to my colleagues. This one-stop capital center—for the benefit of my colleagues who may not have boned up on this, there is a proposal here to establish centers across the country composed of, I guess, SBDCs, SBICs, about five different SBA programs under not necessarily one roof, I take it?

Mr. BOWLES. Well, actually they would be under one roof, Senator.

The CHAIRMAN. Why do you not describe for the Committee how this will work? You are asking for \$300-plus million, are you not, for this program?

Mr. BOWLES. We are asking for \$18.6 million, which would fund \$374 million worth of program.

The CHAIRMAN. Well, describe what you hope to benefit. What is the attraction of this one-stop capital center? Is Little Rock going to get one?

[Laughter.]

Mr. BOWLES. Clearly one of the things that became increasingly evident to me as I toured the country was that the sector of the small business populace that is most starved for capital are those areas located in our poor rural communities, in our inner cities, and within that group those small businesses owned by women, owned by minorities, and particularly, even within that framework, those seeking capital of less than \$200,000.

Building upon the concept that you so rightly put together, the microloan program, we tried to think about how we could bring capital to that area of the marketplace. I had been involved in a community development bank in North Carolina called the North Carolina Self-Help Credit Union, and originally when that program was started it only gave advice. And as you all well know, advice only carries you so far.

It then got a grant from a foundation and it only gave money, and that was equally unsuccessful, because you need both the advice and the money. That is what that small business needs to have its chance, first to survive and then to grow and prosper.

So what we tried to do was to think, if in fact the microloan program would service the need of the zero to \$25,000 market—and that is a big, big market, because the average loan made in the microloan program is about \$7,500. Well, if you consider the fact that two-thirds of the businesses started in America are started with less than \$10,000 in capital and half are started with less than \$5,000, you can see that that program itself can meet a big need for capital in the small business marketplace.

But it also was equally clear that, almost regardless of the liquidity in the banking system, that the commercial banks had little incentive to make that loan between \$25,000 and \$150,000, and the reason is it takes as much time and you have as much cost in making a \$50,000 loan as you do a \$5 million loan. And not only do you have the same up-front cost, but once you make the loan you have a lot of maintenance costs because that borrower needs that advice and that technical assistance that we give in the microloan program.

So what we tried to do was think how could we make loans to fill that medium marketplace between \$25,000 and \$150,000? How could we make those and also take some of the risk of that loan out of that credit?

Well, what we decided to do was to steal your concept in the microloan program and steal that concept that we used at the North Carolina Self-Help Credit Union and use it with larger loans. Therefore, we decided to put in one area the microloan program, to focus on the zero to \$25,000 market, offering both the credit and the advice. We decided to put in a small business lending company, which is something we have at the SBA, which is basically a non-bank. We put it down there to focus on that market between \$25,000 and \$200,000, and we would put right beside it an SBDC, a small business development center, a SCORE operation, which are our retired executives, and a BIC, which is our business information center.

Everyone who borrows money from the SBLC, the small business lending company, would be required to have that personal banker there to offer advice and to counsel that company for a number of years during its early stages. We felt therefore we could take some of the risk out of the loan, increase the chance that we would be paid back and also the chance that the business would grow and prosper.

We also were going to put down there a community development corporation to bring the long-term funds to the small business, and also an SBIC and an SSBIC to provide the equity capital.

Therefore, in one place a small business would be able to go for both the capital and the advice they need in our poor rural communities and inner, inner cities.

The CHAIRMAN. Mr. Bowles, let me just conclude with this comment. Using community development block grant funds to help finance these at the local level is using Federal money to match Federal money, and I have to say I really have a problem with that.

Mr. BOWLES. I have heard a number of people express objections to using community block grant money to capitalize the SBIC. We have talked about that as one alternative. We have also talked to any number of commercial banks who have expressed an interest in funding some of the SBLCs.

The CHAIRMAN. Senator Pressler.

**STATEMENT OF HON. LARRY PRESSLER, A U.S. SENATOR FROM  
THE STATE OF SOUTH DAKOTA**

Senator PRESSLER. Thank you, Mr. Chairman. I ask unanimous consent to place my opening statement in the record.

The CHAIRMAN. Without objection.

Senator PRESSLER. Thank you. Administrator Bowles, welcome.

[The prepared statement of Senator Pressler follows:]

**PREPARED STATEMENT OF SENATOR LARRY PRESSLER**

I would like to thank Chairman Bumpers for holding this hearing on the Small Business Administration's FY 1995 budget request. I look forward to working with the Chairman during this session on this and many other important issues affecting the small business community. I also would like to welcome the Administrator of the Small Business Administration, Erskine Bowles, and thank him for being here this afternoon. I have some brief comments regarding the SBA's budget request and look forward to Administrator Bowles' testimony.

The Small Business Administration is undergoing a period of transition. It is unfortunate that the Administrator's attempts truly to reorganize the agency were sidetracked by parochial interests.

When Administrator Bowles came to us for confirmation, he admitted to being a political novice who would need some time to understand the ways of Washington. I dare say that at the very least this effort provided him with a serious educational experience.

Furthermore, the SBA has been the source of a variety of scandals. As a result of the agency's activities involving such things as Whitewater and the production of slick, pro-Administration health care reform brochures, many have come to view the SBA as a haven for waste, fraud, and abuse. As a consequence, members of Congress need to take a hard look at SBA's FY 95 budget request. The proposed budget only calls for a less than 1 percent overall budget increase. However, hidden within the details are significant increases for programs that have suffered major losses and experienced serious problems over the years.

Additionally, the budget calls for unfair and potentially unworkable user fees for some of SBA's programs. For example, it would impose a \$15 an hour fee for entrepreneurs seeking counseling at their local Small Business Development Center (SBDC). Fifteen dollars may not seem like a large amount of money to pay for counseling in New York City, but for hard working people seeking to start a small business in Yankton, SD, it is a substantial fee.

The budget also calls for a \$30 million dollar appropriation to subsidize the repayment of high interest 503 Program loans. This is an admirable goal, but the Administration should offer a \$30 million offset to pay for this initiative.

Moreover, the budget would significantly increase the interest rates for disaster loans. Rural America already has been decimated by floods, it does not need the burden of higher interest rates.

I do want to commend the SBA for seeking to eliminate \$31 million dollars worth of pork-barrel projects the agency funded in FY 1994. I just wish the Administration showed similar fiscal restraint with its other proposals.

Again, I welcome Administrator Bowles and look forward to his testimony.

Senator PRESSLER. In general, how do you—if you had to do it in one or two sentences—justify this budget request. I know you have covered part of this, but your agency is seeking an increase in funding, while other agencies are cutting their budgets. With the serious budget constraints we face, how would you justify that to a citizen on the street?

Mr. BOWLES. Very easily, sir. Let me give you some real numbers. In 1993 our total budget authority was \$1.2 billion. In 1995, I am requesting \$806 million. That is \$402 million less, or 33.3 percent less. Now, if you take out disaster, which distorts our numbers, in—

Senator PRESSLER. I'm sorry. You mean you are seeking a decrease for FY 1995?

Mr. BOWLES. Yes, sir.

Senator PRESSLER. What was the 1994 figure?

Mr. BOWLES. I am going to get to that. In 1994, we had \$798 million authority and we are requesting \$806 million. That is an \$8 million increase or a 1.0 percent increase. At the same time, our agency credit programs have grown from \$7.4 billion to \$11.9 billion. That is a 62.2 percent increase in our program.

I think a one percent increase in our budget authority is probably pretty reasonable in light of a 62.2 percent increase in our program. I think that is what is called leverage and real bang for your buck.

Senator PRESSLER. There have been large losses over the years in some SBA program areas and you have covered some of this. But again, how are you going to ensure against even bigger losses in the SBIC and the MESBIC programs?

Mr. BOWLES. First of all, as it relates to the SBIC program, as you may know, Senator Pressler, we have brought in a new management team for that program. We brought in Bob Stillman, who is considered, has been throughout his career on Wall Street, to be one of the most respected men in the venture capital and investment banking industry.

I did not bring him in because he was a Republican, but he does happen to be one. He was a client of mine and someone I have worked with. He is a highly respected man and I am confident he can manage that program.

But we will monitor that program more closely. We will audit that program more closely. And we are also going to license and license hard. We are only going to license proven, experienced venture capitalists, and in that way, if you license hard, your problems in the future will be very, very few.

Senator PRESSLER. Why are you asking for such a large increase in the 504 program and what is the current default rate for the 504 program?

Mr. BOWLES. We are asking for about a \$1.1 billion increase in the 504 program from FY 1994 to 1995. We are asking that because of the huge demand. You have to remember that it has our lowest credit subsidy rate.

The weighted credit subsidy rate in our 504 program is only about .56 percent. That is where the taxpayer gets really the biggest bang for their buck. I wish we could get all of our programs to be as efficient as the 504 program is.

In addition, the funds in the 504 program are all used for economic development and to rebuild our cities. I think it is probably one of the best programs the SBA has. It is surely one of the most cost efficient programs. The loss ratio is about 2.1 percent. It is very low.



Senator PRESSLER. Okay. Now, I understand you propose to charge \$15 an hour fee for counseling at small business development centers. How much do you expect that fee to raise and how do you think that is going to go over?

This is the first time that a fee has been proposed for this program, is it not? Maybe it is a necessary thing. I do not know.

Mr. BOWLES. Let me just say first why we are doing it. To answer your question specifically, it is \$15 per hour and we hope to bring in \$17 million as a result of it.

The concept behind the fee is that we felt that if people paid something to utilize the service that they might value the service more, and if they value the service more they might do more homework ahead of time before they went to the SBDC and therefore they would get much more out of the time they spent with the SBDC business manager, and therefore he could use his time or she could use her time much more productively and we could get more bang for the buck in that way.

The SBDC operation does charge for training and counseling already. They do not charge in the manner that we are suggesting. What is the amount they charge, Arnie, now, for that?

Mr. ROSENTHAL. They charge about \$25 for the training.

Mr. BOWLES. We generate about \$6 million. They keep those fees themselves now.

I might add that over at the Commerce Department, at the MBDA, they charge \$50 an hour and then they buy down that cost by 80 percent for people with less than \$500,000 of revenues and buy down those that have greater than \$500,000 revenues by 65 percent. So their fees actually can be higher than the fees we are talking about charging.

But again, we believe it will enable us to do more with less.

Senator PRESSLER. You have touched on this, but your budget calls for a significant increase in the interest rate for disaster loans. Why did you raise the interest rate on this program as opposed to your other assistance programs?

Mr. BOWLES. During my opening testimony I said I believe that we could go forward. We have done some re-examination of the program and at this time we believe that we can go forward without raising that interest rate to the Treasury plus one percent.

Senator PRESSLER. I am pleased to hear that. One thing I have been very concerned with is that small town disasters or rural disasters be treated as quickly and efficiently as some of the highly publicized urban disasters, and I am not taking anything away from the needs of California or Florida during earthquakes or hurricanes. However a tornado in a small South Dakota city that destroys four or five businesses does not make national headlines, but it is just as devastating to that community. I think your agency has been quite responsive in South Dakota when we have had those types of situations.

However, in general the responsiveness of the SBA to the recent California earthquake was far superior to that of the great flood of 1993, let alone to isolated disasters occurring in sparsely populated areas. Specifically, I notice that the lending caps for home and personal loans were doubled, according to an SBA press release, in response to the needs of Los Angeles.

What prompted this dramatic change in policy? How will this action, along with the proposed budget cuts, affect the future availability of disaster assistance? And I guess the core of my question is: Are you as quick to respond to a small city's disaster that does not enjoy national press coverage or national concern as you are to ones that occur in the big media centers?

Mr. BOWLES. I think I can answer that question unequivocally yes. I think we learned a lot in the Midwest floods, Senator. As you said, from your own experience with the SBA, that you in South Dakota have experienced no problems with our service.

We have worked hard at reducing the loan documentation forms at the SBA for disaster relief. We really have worked hard at taking the bureaucracy out of our programs to make them more user-friendly, and that is why we can move much more rapidly now than we could in the Midwest floods. That is why I believe we are delivering better customer service today than we did during the Midwest floods.

We did learn a lot from that experience and we believe that our customers have profited from it. But under no circumstances should we give better service in California or in Chicago or in St. Louis than we give in Sioux Falls, South Dakota.

Senator PRESSLER. There was a controversy last year regarding the health care brochure that was printed by the SBA and the 800 telephone number that your agency was involved with. What is your feeling about this issue? Was there money spent that should not have been? Will these sorts of things be continued?

There was some feeling, at least on my side of the aisle, that the health care brochure was advocating the administration's health care plan at government expense, and I think you have received letters from some of us and some of the House members.

Mr. BOWLES. I sure did. The health care brochure we printed up was done specifically for the purpose to educate the small business owners. Clearly, health care is the number one issue facing small business owners today. All of the health care proposals that are out there are complicated. We felt it in the best interest of the small business owners to use some of the money that we have for publications, out of our publication budget, to educate and inform the small business owners.

We have every authority to do that under the Small Business Act, and as such did such.

Senator PRESSLER. Speaking as one Senator, I found it a little too one-sided as it did not present anything on the alternatives, and I had difficulty with that expenditure.

Now, your budget calls for a major increase in the SBIC program. Obviously there have been some scandals and some alleged scandals in this program. What steps are you taking to head those off?

Mr. BOWLES. As I said in an answer to an earlier question, we are taking every step you possibly can take to prevent fraud and abuse. We have increased our auditing. We are more closely monitoring the program. We have far, far tighter licensing requirements, and we are emphasizing quality management.

In addition, we brought in a new management team to run the SBIC program and we are confident that that new management

team, combined with the new Participating Securities program, which the Congress passed, I think 99 to 1, will make this program a program that we all can be very, very proud of.

Senator PRESSLER. My last question, Mr. Chairman, and perhaps I will have some in the second round, involves the small business set-aside program. I have just come back from Portland, OR, where I addressed loggers and others who make their livings in our western forests, and they are concerned about the timber set-aside program.

Is this a costly program or is it used essentially only to make declarations that so much of our forest resources are available to small business?

Mr. BOWLES. Senator, I do not have exact information with me now, but I will be happy to get that to you.

Senator PRESSLER. I do not think that this is an issue of a budgetary increase or decrease, but many small business owners are very eager to work with you on the set-aside program. Small businesses involved in timber industry already are having a hard time working it because of environmental lawsuits in which they have to hire a lawyer every time the Sierra Club or any other seeks to prohibit them from cutting timber that is environmentally approved by the Forest Service.

I guess my questions for the record would be: Is the program costly? Is the cost going to increase? I do not think it is very costly. I think it is a declaration of a certain amount of the lands to be—

Mr. BOWLES. Set aside for small businesses.

Senator PRESSLER. Yes.

Mr. BOWLES. In the Federal timber.

Senator PRESSLER. So that small businesses are able to cut a certain amount of the timber available.

Is there anything being planned in regard to the future of the program? Any other comments you might have on the timber set-aside program—which is of great interest in western South Dakota and in the Pacific Northwest, as well as throughout the country wherever is timber harvested—would be greatly appreciated.

Mr. Chairman, I yield the floor.

[The information referred to follows:]

#### NATURAL RESOURCES SALES ASSISTANCE (NRSA)

The purpose of the Natural Resources Sales Assistance Program is to aid and assist small business in obtaining its fair share of Federal property offered for sale or disposal by other means. Within this Government-wide program, our efforts have been concentrated on the sales of Federal timber, royalty oil, coal leases, other mineral leases and Federal surplus property sales.

During the first half of FY 1993, small business was awarded over 724 individual Federal timber sales, representing approximately 796 million board feet of sawtimber at a return to the Government of nearly \$257 million. Small business awards represented 64 percent of total Federal sawtimber sold in the first half of FY 1993. The small business timber program assures that the small business community will receive its historical fair share of Federal timber through small business set-asides.

The CHAIRMAN. Thank you.  
Senator Wellstone.

**STATEMENT OF HON. PAUL WELLSTONE, A U.S. SENATOR FROM  
THE STATE OF MINNESOTA**

Senator WELLSTONE. Thank you, Mr. Chairman. Mr. Chairman I do have a statement I would just like to have included in the record.

The CHAIRMAN. Without objection.

Senator WELLSTONE. Mr. Bowles, I want to make a couple of comments and then ask a couple of questions. But by way of beginning my comments, when you first appeared before the committee I remember some of us said that we welcomed someone with your background. Just speaking for myself, and I think I speak for everyone: I do not regret for one moment that you are in a major leadership position. I think you have done a tremendous job and I think you have brought a kind of intellectual and policy ferment to SBA, and it is something we have not seen for a long time, and I thank you for that.

I appreciate your discussion about targeting some of SBA's loan programs. You mentioned inner city communities and you also mentioned rural communities and you mentioned women and minorities. I also would add, although it is not in your budget, that I support the idea of targeting to make a linkage between small business and high wage jobs.

I think this is part of the overall mandate for our economy, and I think especially speaking from a rural perspective I think that is very, very important, and want to commend SBA for beginning to look at that idea.

Did you want to respond to that?

[The prepared statement of Senator Wellstone follows:]

PREPARED STATEMENT OF SENATOR PAUL WELLSTONE

Thank you, Mr. Chairman. And thank you Mr. Bowles for being with us today.

I remain excited about the prospects for small business policy under this Administration. I think the President's proposed FY 95 budget for SBA reflects his support for small business programs, and I am particularly pleased to see that room has been made for increases in SBA's two primary loan-guarantee programs—the 7(a) and the 504 programs.

Demand for these two programs has increased dramatically in Minnesota. Demand for 7(a) loans has increased 20–30 percent annually in recent years, and, as you may know, Mr. Bowles, our SBA District Office, which is in Minneapolis, led the entire nation in both the number and dollar-value of 504 loans last year. I will not be surprised if they do so again this year.

Minnesota small businesses make very good use of SBA programs.

It is for this reason that I would like to commend you for one of your first efforts as Administrator, which is the beginning of distributing some resources and personnel away from Washington, toward the district offices. I have to point out that the two new loan officers our District Office may gain through this effort will only allow us to hold even, since two others are retiring and couldn't be otherwise replaced. But the idea is obviously a good one. Turnaround time on loan applications in our District Office is currently 5 weeks rather than the target of 3 weeks. That is no fault of our overburdened loan officers, two of whom are just now detailed to California for the earthquake-relief effort.

Mr. Bowles, we were very pleased last year to welcome someone of your background to the position of Administrator, and we have not been disappointed. There is already a positive feeling of intellectual and policy ferment coming from the agency.

I know that one idea you are proposing is to expand the current pilot program which allows a low-documentation process for 7(a) loans under \$50,000. This would really help to direct loans toward that niche between microloans and larger 7(a) loans, and I hope our Minneapolis office will become a site for that expansion.

I look forward to working with you on that and other ideas as we continue to look at SBA programs for possible improvement.

Mr. BOWLES. Just two things, Senator Wellstone.

Senator WELLSTONE. I would like to work with you on that. I am very interested in that particular area.

Mr. BOWLES. Thank you. I appreciate your compliments. But I will say unequivocally we have assembled a very good team at the SBA. It is a team of experienced people from the private sector who have come to the SBA to work with the career employees, and we have worked long and hard to earn the trust of the career employees. I think together, working the hours we have worked, I believe that we really have achieved some real buy-in throughout our districts and throughout our regions and throughout the central office, so that we can be a more efficient, more effective, more user friendly organization.

Senator WELLSTONE. I am pleased to see that room has been made for increases in the 7(a) and 504 programs, and I agree with what you said about the efficiency of the 504 program. Of course, I cannot help but agree with you because our district office in Minneapolis, as you well know, is very active. I think we led the Nation both in the number and the dollar value of those loans last year, and I would not be surprised if we do again.

Now, here is one—I may be swimming upstream on this, but here is one concern I have. I do not know whether you can do that much about it. I think on the one hand all of us applaud your effort to move away from—to try and transfer some of the resources and personnel from Washington out into the field offices.

We have a great district office. I mean, I brag on the work they do in Minnesota. The problem, however, is, even though we have great people, we are still getting—Mr. Chairman, it is taking about five weeks to process these loan applications. You would want to see something more in the area of 3 weeks in terms of turn-around time.

That is because, even with the transfer of some additional man and womenpower, we also have two people who are retiring, so we do not have any net gain. And I know that right now you are not in a position to give us that net gain. We have also got a couple of people, interestingly enough, on detail in California right now, which I do not think anybody for a moment questions. You know, the support is needed out there.

But I just want to express to you that the streamlining of the forms and all the rest is extremely important, but sometimes what I find as a big concern is that we pay a price for our very success. We really do not have the man and womanpower that we need out in the field office.

Mr. BOWLES. I think that is clearly true. We are making, for the first time, a real effort to do that. For the last 12 years, the SBA had about 4,000 people at the beginning of that period, it had about 4,000 people at the end, but they ended up that period of time with about a third fewer people in the field, and those people got shifted to the regional offices and to the central office.

Well, I do believe that is counterintuitive. I do think you should put your assets where your customers are. I believe our people in

the field, just like the ones you mentioned in Minnesota, are doing a fabulous job.

Senator WELLSTONE. They are.

Mr. BOWLES. With very limited resources. But what I have to do now is to shift as many of those people as I possibly can from Washington and from the regions back to the districts. We have too many people at the SBA still involved in doing other things other than working directly with our customers.

I have two overriding problems, though. One is we have to have an overall reduction in the number of people who work in the government, and I have to do my part to contribute to that reduction in the work force.

Senator WELLSTONE. Right.

Mr. BOWLES. And I am committed to doing that. So that is one reason why I will have overall fewer people. Then in addition to that, because I have to absorb the locality pay, I have far fewer people that I can fund below the number that I have been authorized for. And in fact, if the Congress sees fit to give a projected pay raise next year, that is not in this budget and I will have to absorb that with fewer people if you give that pay raise.

Those are the kind of things that happen to a manager as you go through trying to live with the way the budgets are put together in the government.

Senator WELLSTONE. Well, I said I was swimming upstream. I think that the argument about the bureaucracy and cutting sometimes is tiring and tiresome. It depends on who you are talking about.

I happen to think that some of these programs are extremely important and I am saddened to see some of it, because I think we are paying a price. That is my point.

Mr. BOWLES. But we will have more people in the field.

Senator WELLSTONE. Good.

Mr. BOWLES. We will have fewer people in Washington, and fewer people in the regions.

Senator WELLSTONE. Good.

Mr. BOWLES. And we will give better customer service.

Senator WELLSTONE. Now, on this low documentation process for the 7(a) loans under \$50,000 that we have heard so much about in some great States like the great State of Texas, I just want to tell you that our Minneapolis office would be proud to be a site for such a program. It fits that niche between \$50,000 and the micro-loan, and we would be very anxious to participate in this.

Mr. BOWLES. Mr. Cox is sending in our credit review team to analyze the loans that have been made. We want to make sure we are doing this right. We want to be very careful with the taxpayers' money. But we are sending in, I think it is next week or this week, our credit review teams.

We are going to make sure that we are making the kind of loans that the taxpayers expect us to make, that we are not taking inordinate risks by utilizing this program. We do not believe we are. We are watching it very closely. But if in fact we have been prudent with the taxpayers' money, then I think you can see us take this program on a national basis in the near future.

Senator WELLSTONE. Sure. I understand you are in a pilot project, and if the record speaks for itself, you will expand it. I am just telling you that we would be very anxious to participate.

Two quick questions. I am a big fan of the microloan program. I have found some real inspiring success stories. Now, I notice you are going to shift from a direct loan to a loan guarantee program with the microloan.

Mr. BOWLES. Yes, sir.

Senator WELLSTONE. The A part of my question is: What budget savings do you project from such a shift? Then the second part of my question is: Are the banks going to be asked to offer a special interest rate, or how exactly are we going to do this?

Mr. BOWLES. The savings in the first year are very, very minimal. The credit subsidy rate of 12.16 is slightly below what it would be if we were not going to a guarantee program, and that is because it is a 100 percent guarantee program. We feel like over time that we will be able to reduce the guarantee, first to 95 percent and then perhaps as low as 90 percent.

That will again give us much more bang for our buck. In addition, by the bank absorbing some of the administrative cost it will save us some dollars in that regard, so it will enable us to be more efficient and more effective. I think it will have zero effect on either the microloan intermediaries or on the microloan borrowers.

Senator WELLSTONE. Well, we have four intermediaries in Minnesota and that is why I asked the question.

Finally, Mr. Bowles, I want to extend to you an invitation to come to Minnesota. I know you have been doing some traveling in other States and I would love to call your office and have you out in Minnesota.

Mr. BOWLES. Thank you.

The CHAIRMAN. Thank you, Senator Wellstone.  
Senator Hutchison.

#### STATEMENT OF HON. KAY BAILEY HUTCHISON, A U.S. SENATOR FROM THE STATE OF TEXAS

Senator HUTCHISON. Yes.

Mr. Bowles, I want to just say one thing about one comment you made about previous administrations wanting to abolish the SBA. I understand that Mr. Stockman at one point made some references to that, but no action was taken, and the Bush Administration was very supportive of the SBA and small business, the President having been a small business person. I too am very supportive of what you are doing. But I did want to make the point that the Bush Administration was very supportive.

Also, it was during that administration that we started requiring fewer pages in the loan applications, because as State Treasurer of Texas I was part of that beginning effort. I want to compliment you for expanding on that and making it grow, because I think it is a very good program.

Also, I want to mention something you might mention consider at SBA as one of the things that could be done in other States to encourage SBA loans to be purchased. In Texas, we purchased with our State treasury dollars the guaranteed portion of SBA loans

from the banks that were participating, to get them off the banks' books so that they could have more options, hopefully, to go out and make more loans. We ended up buying around \$20 million dollars in loans. I think it was a great partnership between the SBA and the State treasury, and you might want to look at that in some of the other States as a partnership that would free up more money to go for those loans.

I also want to compliment you on the women's prequalification loan program that you are doing in Chicago. I think there is a de-emphasis in this country on women and some of the hardships that small businesses started by women face, and I am glad to see that you are focusing on women, because most of the new small businesses created in this country right now are created by women, and it is a great job market.

I would like to be kept apprised of the progress on that and I hope, if you make a success of it and help the women that are able to prequalify, that you can expand that program as well. How long do you think it will take to get an idea of how much interest is out there?

Mr. BOWLES. On the women's pilot project, we are actually going to have, I believe, eight of those. We are going to have one in Chicago, one in Columbus, Ohio, one in Albuquerque, NM, one in Helena, MT, one in New Orleans, Charlotte, Salt Lake City, and San Francisco. So those are the districts that have expressed an interest in having this pilot project for women.

We do think it can be very, very successful, but we wanted to test market it, just like you would any other product. We do believe that once we have a chance to evaluate it, just like we had with the LOWDOC program, we will be able to take it further.

Senator HUTCHISON. I believe if I am not mistaken that maybe Mr. Cox was in a meeting I had with the previous administrator. Have you been with the SBA for a while?

Mr. Cox. Yes.

Senator HUTCHISON. I think you were part of that program to start this documentation simplification program.

Mr. Cox. Yes. That was in reference to a short form that we had previously, but it mandated all the attachments that we would have on a regular form.

Mr. BOWLES. This (indicating) is actually a brand new form that we came up with ourselves in the last two or three months.

Senator HUTCHISON. Yes. I applaud you for it and I think it is terrific, and I am very supportive of it. I think that we are now beginning to really get into the small businesses that really do need the help in this country. I know as a small business person myself many years ago, I looked at SBA loan forms and decided to go conventional.

Mr. BOWLES. Sure.

Senator HUTCHISON. I think going into an \$18,000 loan with that one short form is absolutely terrific. I applaud you for it and will certainly be supportive.

Mr. BOWLES. Thank you, Senator.

Senator HUTCHISON. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hutchison.



Just two or three concluding questions, Mr. Bowles. The one-stop capital center idea has a lot of appeal to me. As I told you, I am very much concerned about allowing the use of community development block grant money to replace private money on that. But another thing is, as I understand it, these are calculated to be built in high-risk areas and as a result the subsidy rate for 7(a) loans would go from 2.15 in 1994 to 2.73 in 1995. Is that correct?

Mr. BOWLES. Yes, sir. If I could expand on that a little bit, the subsidy rate excluding the empowerment zones goes from 2.15 to 2.65 for several reasons.

The CHAIRMAN. Is it 2.65?

Mr. BOWLES. Yes, sir, for reasons other than the empowerment zones. Some of that is because we did not receive as much of our 50 percent fee on sales in the secondary market above a level of 110, so OMB made an adjustment. And that is the principal reason why our fee goes from 2.15 to 2.65.

The increase in the weighted subsidy rate from 2.65 to 2.73 is a direct result of the empowerment zones, and that is because the loans in the empowerment zones were given a credit subsidy rate which is twice as high as the credit subsidy rate of those not in the empowerment zones.

The CHAIRMAN. Are you saying that by reducing the additional subsidy from 2.65 to 2.73—

Mr. BOWLES. Is due to the empowerment zones.

The CHAIRMAN. So the reduction in loans would be minuscule as a result of that loss of subsidy?

Mr. BOWLES. Absolutely.

The CHAIRMAN. The second thing I wanted to ask you is, you know, we have been waiting with bated breath in Little Rock for some time for one of these loan servicing centers and, as we say in Arkansas, we cannot get no hearing. Could you enlighten us as to when we might expect some action on that?

Mr. BOWLES. Absolutely. The answer is as soon as I can afford it. Because of the need to absorb locality pay and because I may not be able to through attrition reduce my work force as quickly as I would like to, then I have had to put the loan servicing center on hold until the last quarter of this fiscal year.

I hope by the end of the last quarter of this fiscal year I will have saved enough money to begin the loan servicing center in Little Rock. It absolutely makes sense. The currency rate of our loans in the loan servicing center in Fresno is 9 percent better than the currency rate throughout the SBA. It does enable us to be much more efficient, much more effective. It is doing the loan servicing the same way it is done in the private sector, as you know, Senator Hutchison.

It makes a lot of sense. I simply just cannot afford to do it until the last quarter of this fiscal year and then to carry forward and finish it up in the first and second quarter of next year.

The CHAIRMAN. Mr. Bowles, what is the total figure for 7(a) loans in fiscal year 1993?

Mr. BOWLES. In 1993, it was \$6.4 billion and that took \$334 million worth of credit subsidy authority. So it took \$334 million to make \$6.4 billion worth of loans. We will make just about \$7.5 bil-

lion worth of loans, so we will make more loans at a cost of only \$207 million in 1995.

The CHAIRMAN. For 1995?

Mr. BOWLES. Yes, sir.

The CHAIRMAN. Is that what you are talking about when you say "this year"?

Mr. BOWLES. That is what I meant to say, yes, sir, 1995.

The CHAIRMAN. Well, how many loans do you anticipate making this year, 1994?

Mr. BOWLES. At this time, we expect to make approximately \$7.0 billion worth in 1994, at a cost of \$150.5 million.

The CHAIRMAN. When you said "last year," were you talking about 1993 or 1994?

Mr. BOWLES. In 1993, we had credit subsidy authority of \$334 million and we made \$6.4 billion worth of loans.

The CHAIRMAN. Okay.

Mr. BOWLES. In 1994, the year we are currently in, we will probably use \$150 million and we will make about \$7 billion worth of loans.

The CHAIRMAN. Do you anticipate running out of money?

Mr. BOWLES. No, sir, we will not run out of money. We in fact believe that we will have some carryover authority into 1995 and have forecasted such.

The CHAIRMAN. I am sure you signed off on—as a matter of fact, I was going to vigorously oppose it, but they told me that you had signed off on it and the White House had signed off on raising the maximum disaster loan from \$500,000 to \$1.5 million during the Midwestern floods.

I do not want to ask you an embarrassing question. Was that your idea or the President's idea of going along with that? I did not like it. I thought it was too precipitous an increase. We have a tendency to get very emotional around here when there is a disaster.

Mr. BOWLES. The vast majority of the business loans we do are way under \$500 million, much less the 1.5—excuse me—the \$500,000, much less the \$1.5 million. We have to go to the \$1.5 million level very, very rarely. It does appear that when we need to go to that level there are a large number of jobs that are involved and it does tend to make good sense.

The CHAIRMAN. Can you give me a guess as to how many, well, let us just say, how many applications did you get in the Midwest for \$1.5 million, or say between a million and 1.5 million?

Mr. BOWLES. Not many. But let me get the information for you.

The CHAIRMAN. All right.

Mr. BOWLES. As I remember, it was not many.

[The information referred to follows:]

**SBA Disaster Business Borrowers with Loan Approvals over \$500,000 (Old Statutory Loan Limit)**  
**(for disasters commencing 4/1/93 or after, and subject to the new statutory loan limit of \$1,500,000)**  
 (all data through February 24, 1994)

| <u>State</u>                   | <u>Number of<br/>Business Borrowers<br/>Loans over \$500,000<br/>and up to \$1,500,000</u> | <u>Total Amount of<br/>Disaster Loans<br/>over \$500,000<br/>and up to \$1,500,000</u> | <u>Number of<br/>Business Borrowers<br/>Loans over \$1,000,000<br/>and up to \$1,500,000</u> | <u>Total Amount of<br/>Disaster Loans<br/>over \$1,000,000<br/>and up to \$1,500,000</u> |
|--------------------------------|--|--|--|--|
| <b>Midwest Flood Disasters</b> |  |  |  |  |
| Illinois                       | 11   | \$ 10,154,700  | 4  | \$ 5,164,100   |
| Iowa                           | 26   | 21,212,300   | 6  | 7,438,600  |
| Kansas                         | 4  | 3,382,300  | 1  | 1,334,600  |
| Kentucky*                      | 3  | 2,306,600  |  |  |
| Minnesota                      | 7  | 4,776,500  |  |  |
| Missouri                       | 54   | 54,785,700   | 23   | 31,861,800   |
| Nebraska                       | 3  | 2,317,700  | 1  | 1,258,700  |
| South Dakota                   | 1  | 987,100  |  |  |
| <b>Other Disasters</b>         |  |  |  |  |
| California,<br>wildfires       | 4  | 2,849,400  |  |  |
| earthquake                     | 2  | 2,275,700  | 1  | 1,500,000  |
| Guam                           | 2  | 1,357,500  |  |  |
| Louisiana                      | 1  | 629,300  |  |  |
| New York                       | 2  | 2,015,500  | 1  | 1,500,000  |
| Oregon                         | 1  | 502,000  |  |  |
| Virginia                       | 1  | 609,300  |  |  |
| <b>TOTAL</b>                   | <b>122</b>   | <b>\$ 110,161,600</b>  | <b>37</b>  | <b>\$ 50,057,800</b>   |

\* economic injury disaster loans approved in counties contiguous to Illinois counties included in Presidential flood declaration

The CHAIRMAN. Also, for the Los Angeles earthquake, while we are at it. Senator Harkin first came to me with that. It was his amendment on the floor of the Senate, as you will recall. They wanted to change the formula on disaster loans and I said: Well, I will go along with the change to the formula if you make it retroactive from 1991 to cover the Red River floods in my State and Louisiana and Texas.

I understood him to say that was okay. And I am not criticizing Senator Harkin. It did not turn out that way. The people in Arkansas, Texas, and Louisiana did not qualify under the formula change.

But in any event, these things can really get out of control. One of the reasons I am going to oppose this balanced budget amendment we are getting ready to debate here is, what are you going to do when you have an earthquake like we had in Los Angeles, where the Federal Government is expected to pick up \$10 billion worth of tab, and \$10 billion in the Midwest for the floods? Are you going to say to those people, we are really sorry, we passed the balanced budget amendment and went home, patted ourselves on the back, and said, ain't this wonderful, and it just so happens we cannot do anything for you?

But as I say, while I am very compassionate and I want to help those people, I thought that that went beyond the pale. But I would like any figures you can give me on both of those disasters.

Mr. BOWLES. Yes, sir, I can get you exact figures.

The CHAIRMAN. On the small business institutes, I think that has been a pretty good program. It is very small. It serves over 6,000 small businesses annually for \$3 million, which seems to me like a fairly reasonable, good deal. But I am probably not going to argue about that.

As far as your suggestion that you are going to raise \$17 million in fees for businesses that use small business development centers, I do not know what kind of a formula you use to arrive at that figure. I do think I would probably stand on my head on the Washington Monument the day you do that.

We will talk about it again one year from now. I have no objection to it, but I just think an awful lot of people use SBDCs because they are free, and unless you took an awful lot of that into consideration in coming up with that \$17 million, you are going to be way off the mark, I am afraid.

Senator Pressler, do you have any additional questions?

Senator PRESSLER. I just have a couple, and also one comment. I heard the comments made about Little Rock. Now, Administrator Bowles, you are going to treat Sioux Falls on an equal basis with Little Rock, is that correct?

The CHAIRMAN. Oh, you are not even in our league. What are you talking about?

[Laughter.]

Senator PRESSLER. There would not be any reason you would treat Little Rock better, would there?

Mr. BOWLES. No, sir.

Senator PRESSLER. Okay, good.

Now, the position of chief counsel for advocacy has been vacant for more than one year. When is the Committee going to receive a formal nomination?

Mr. BOWLES. The President announced his intent to nominate Jere Glover, I believe it was back in November. It is in the process now. My hope is that it comes to you in the very, very near future and that your Committee will sit down and confirm Mr. Glover as soon as possible. I do not know where it is at this particular point in time.

Senator PRESSLER. As you will recall, sloppy lending practices in California, one of the 7(a) loan program's biggest markets, resulted in millions of dollars of fraudulent loans being made—a burden borne by the American taxpayer. What is the current default rate for the 7(a) program? What type of progress has been made in the oversight of this program?

Mr. BOWLES. We have brought the loss rate for the 7(a) program down consistently over the last several years. I think it is around 2.13. He says it is 2.04 percent now. So the loss rate is pretty reasonable.

We did have a problem out in California for sure. It is a problem we discovered ourselves. Some loan packagers were presenting fraudulent tax records to the SBA. The way we discovered it is we looked at some of the margins for some of the businesses and they were out of line with industry margins for companies in that business.

We sent off to the IRS for the tax returns ourselves and we found out we were receiving some fraudulent tax returns. We immediately began to ask for tax returns from the IRS itself with every loan application we took in California and the problem dried up immediately.

We are now asking on a random basis throughout the country for tax returns and we believe this is a problem we have in hand. We are, however—the vast majority of the loans that we receive at the SBA now do come through a packager and as such we are now working with NAGGL to come up with a code of ethics for the loan packagers, as well as appropriate training and supervision for people in the loan packaging business.

Senator PRESSLER. Your budget calls for \$30 million to subsidize the repayment of high interest 503 loans. Why do you not offer a \$30 million offset beyond simply including the request in a budget that cuts other spending to pay for this program?

Mr. BOWLES. To the best of my knowledge, Senator, we are asking for the \$30 million for this program to offset the differential between the 504 and the 503 penalty. This is money we will get from the Treasury, it will go right back to the Treasury. It will not go to any of the borrowers.

Senator PRESSLER. Mr. Chairman, I have some additional questions for the record. I wonder if we could leave the question period open for the rest of the day for other Senators who also might have some.

The CHAIRMAN. We can and we will make that a part of the record. We will give the other members of the Committee, let us say, until the close of business on Friday evening to submit additional questions to the Administrator. Is that okay?

Senator PRESSLER. Very good.

The CHAIRMAN. We would only ask that you would answer them as expeditiously as possible for us.

Mr. BOWLES. Absolutely.

The CHAIRMAN. Mr. Bowles, we thank you very much for your testimony, and I know you need to get going, so we will adjourn this hearing.

Thank you, gentlemen, all of you, for being here today.

[Whereupon, at 3:30 p.m., the Committee was adjourned.]

[Additional material submitted for the record.]

## ADDITIONAL MATERIAL



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416



APR 7 1994

Honorable Dale Bumpers  
Chairman  
Committee on Small Business  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman:

Please find enclosed Administrator Bowles' responses to the written questions submitted by you and other members of the Senate Small Business Committee in conjunction with your February 22 hearing on SBA's fiscal 1995 budget request.

I hope this information is of assistance to you. Please do not hesitate to call upon me or Administrator Bowles if we can be of further service to you or the Small Business Committee.

Sincerely,

A handwritten signature in cursive script, appearing to read "Kris Swedin".

Kris Swedin  
Assistant Administrator  
for Congressional and  
Legislative Affairs

Enclosures

ADDITIONAL QUESTIONS FOR THE RECORD TO ADMINISTRATOR ERSKINE BOWLES, U.S.  
SMALL BUSINESS ADMINISTRATION

QUESTIONS FROM SENATOR BUMPERS

(1) *Microloans*: The Committee is quite concerned that the Administration's proposal to change the loans to the intermediaries from direct loans to 100%-guaranteed loans will adversely affect the program. It appears from SBA's charts that there will be practically no savings in the credit subsidy rate from this proposed change. Why change the program if it is working well now and there will be no savings?

Answer: We are considering moving to a 100% guaranty program because to do so would ultimately provide more leverage of taxpayer dollars, and we feel that we can do so in a prudent manner. The guaranties would only be extended to Micro Intermediary Lenders that have already been accepted into the program by SBA. These lenders are already authorized to receive direct government loans and they meet all the requirements of the program. Therefore the risk of a 100% guaranty is no more than the risk taken under our current direct loan program. We believe that the lenders can do an equally good—and possibly better—job in servicing the loan because they are on the scene. Finally, a guaranteed program will allow SBA to implement a revolving line of credit for the first 5 years of the loan. This would allow the intermediaries to build their portfolios and income streams during those years, and defer principal and interest payments until the last 5 years.

While it is true that there will be little budget savings in the first year of a guaranteed program, we expect that over time, our experience will show low losses that will bring down the subsidy rate and the cost of the program. Additionally, guaranteed loans are less costly to administer, and therefore, SBA would immediately realize savings in this area.

(2) *Small Business Institutes*: Please describe your rationale for proposing to eliminate the SBI program. Although it is a very small program—just over \$3 million per year—it serves about 6000 small businesses annually, often in sites where no other small business counseling is available. That seems to be an efficient use of Federal funds.

Answer: SBA has eliminated funding for the SBI program for FY 1995 because it is necessary to allocate our limited budget resources in the most efficient way possible. We believe the services provided by the SBI schools, while very valuable, are in some instances duplicative of SBDC services.

Of the 500 SBI schools, 177 are in the same physical location as SBDCs. We will be working with our SBDC partners to ensure that small businesses continue to receive the necessary assistance.

(3) *Small Business Development centers*:

(a) Since SBDCs have traditionally had an educational focus and have not charged fees for counseling services, how will the proposal to require them to charge counseling fees change their relationships with their small business clients?

Answer: The proposed fee should strengthen the SBDCs' relationships with their small business clients. The Agency believes that because the current SBDC counseling services are offered free-of-charge, some clients do not make efficient use of the counselors' time and energies.

Asking SBDC customers to pay a nominal charge for the service will encourage them to prepare for the session, thereby increasing the utility of the services and the efficiency of the program. Additionally, many SBDCs currently charge for training, and therefore have already established a relationship with clients that includes the collection of fees.

(b) What are your estimates regarding the cost of the accounting/management system needed to keep track of the fees?

Answer: Although cost estimates are not available, we believe that many SBDCs already have mechanisms in place to collect and account for fees, due to their current charging for training. Therefore, we feel that any additional cost of this proposal would be minimal.

(4) *Small Business Investment companies and Specialised SBICs*:

(a) How will SBA's new regulations affect an SBIC's ability to declare bankruptcy?

Answer: New regulations and activities being implemented by the Investment Division of SBA combine to (1) raise the quality of Licensees, (2) reduce the potential



for bankruptcy, and (3) potentially give SBA additional rights should a bankruptcy filing occur.

#### *Changes to Regulations*

In the future, all SBICs requesting leverage will be required to consent to an operating receivership upon the occurrence of certain events. This means that SBA, subject to judicial enforcement of this new requirement, would have the ability to apply for and receive the institution of an operating receivership without the objection of the Licensee. This will reduce delays that SBA has been subject to in the past.

In the future, all SBICs requesting leverage will be required to consent to the removal of officers, directors, and general partners upon the occurrence of certain events, and the replacement of such individuals with persons approved by SBA. This will permit corrective action prior to additional activities that would further diminish the value of a portfolio. SBA believes this right would be enforceable even if a Licensee has filed for protection under Federal bankruptcy laws.

By eliminating the financing of equity investments with Debentures, the new Participating Security will eliminate the mismatch between sources and uses of funds. This will reduce the need for Licensees to file for bankruptcy protection because of cash flow problems.

The prior approval by SBA of all secured third party debt should reduce a Licensee's exposure to third party creditors and thereby reduce the likelihood that the Licensee will need to file for bankruptcy protection or be placed into bankruptcy involuntarily. This will also reduce SBA's exposure as a subordinated guarantor.

For issuers of Participating Securities, third party debt is limited to Temporary Debt in an amount not to exceed 50% of Leverageable Capital (changed in 1991).

SBA subordination is limited to the lesser of \$10.0 million or 200% of private capital, and can only be in favor of certain lenders.

#### *Operating Changes*

SBA is requiring greater capital to obtain a license. A minimum of \$5.0 million is generally needed for a stand-alone SBIC issuing Debentures and \$10.0 million for an issuer of Participating Securities. Better capitalized SBICs are more likely to be successful.

A more rigorous licensing process with more demanding requirements to obtain a license will result in better qualified management.

Placement of the examination function within the Investment Division makes the examination function more responsive to the needs of the Division.

SBA is providing a standardized valuation policy for the first time. In addition, Licensees will be required to report valuations electronically which will enable SBA to make comparisons between Licensees and over time.

(b) In addition, there is a concern that the abolition of the preferred stock option for the specialized SBICs will virtually eliminate the inducement for an investment company to organize as a Specialized SBIC. What is SBA's analysis of the likely effects of eliminating SSBICs' preferred stock option?

Answer: For FY 1995 we did not request any authorization for 4% Preferred Stock for SSBICs. Debenture financing was increased, however, from \$17 million in FY 1994 to a requested \$65 million in FY 1995. Since debentures are guaranteed, at a 29.59% subsidy rate, while preferred is a direct obligation with a subsidy rate of 33.53%, we are able to offer more financing to SSBICs in debentures than we could in preferred with a comparable authorization. Interest on SSBIC debentures is subsidized for the first 5 years, bringing their current net cost, after subsidy, to around 4%.

In FY 1993, the budget for MESBIC direct financing was \$18.7 million, and \$12.4 million was actually used. For FY 1994, \$15 million was appropriated; during the first half only \$750,000 has been used.

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#### QUESTIONS FROM SENATOR NUNN

##### *A. Small Business Development Center (SBDC) Program*

1. The Small Business Development Center's primary function is the education of small business owners; the owners' efforts and time contributions are the prime vehicle for this mission. How will the SBDC consulting fee affect this relationship?

Answer: The proposed fee should strengthen the SBDCs' relationships with their small business clients. The Agency believes that because the current SBDC counseling services are offered free-of-charge, some clients do not make efficient use of the counselors' time and energies.

Asking SBDC customers to pay a nominal charge for the service will encourage them to prepare for the session, thereby increasing the utility of the services and the efficiency of the program.

2. Universities, state governments, private businesses, and the SBA all play equivalent roles in the funding and operation of SBDCs. How would the proposed consulting fee affect the contributions (financial and otherwise) of these other institutions?

Answer: We do not believe that the proposed fee will alter the relationship SBA has with our SBDC resource partners. We are not aware that the states have any interest in charging fees.

3. SBA estimates the SBDC consulting fee will generate \$17 million in FY95. What are the administrative costs of managing the fee? What is the real return?

Answer: We do not have a firm idea of the cost of collecting and accounting for the fee. Because many SBDCs currently charge for training, we feel that the existing mechanisms used to collect these charges will be used for the counseling fees, thereby minimizing any additional cost.

4. Demand already exceeds SBDC's capacity to provide service for small businesses. How will administration of the consulting fee affect the availability of services?

Answer: The administration of the fee should have only a minimal impact on the availability of services. However, due to the charging of a fee for services that were previously provided free-of-charge, our forecast calls for SBDCs to provide about 1.1 million hours of counseling in FY 1995, which is slightly below the 1.2 million anticipated this fiscal year.

5. How will the consulting fee be levied? Will it be charged only for client-contact time? Will it also include preparation and travel time?

Answer: The fee will be levied only for the time that the SBDC counselor is with the client.

6. A per-hour consulting fee significantly alters the nature of the service provided by the SBDC. Private sector consultants will surely object to this change. How will these objections be met?

Answer: Historically, the Agency as well as the Association of SBDCs have been very sensitive to the potential for conflicts between SBDCs and private sector consultants should the charging of fees be permitted. Therefore, careful consideration was given to the amount of the fee. SBDC fees must not, under any circumstances, be competitive with fees charged by the for-profit sector. The \$15 per hour fee we are requesting is in fact well below what private sector consultants charge for comparable services.

SBA's proposed fee is also consistent with similar fees currently being charged by the Minority Business Development Centers operated the MBDA. The average MBDC charges a fee of \$50.00 per hour. However, that fee is subsidized by MBDA as follows:

Firms with annual revenues of less than \$500,000 receive an 80% subsidy from MBDA and pay only \$10.00 per hour.

Firms with annual revenues of more than \$500,000 receive a 65% subsidy and pay \$17.50 per hour.

The MBDA fee structure varies slightly based on the local economy, availability of alternative services, and the emphasis of the individual centers (i.e. loan packaging, business plan development, etc.).

7. Pre-venture and new firms are the primary benefactors of SBDC services. How will the consulting fee affect these enterprises? How will the fee impact other potential SBDC clients?

Answer: As noted earlier, the imposition of a fee will likely result in most clients being better prepared for counseling sessions. Additionally, SBDC counselors will be able to use their limited time more efficiently. Thus, clients should actually get better service from SBDCs than they currently do.

#### *B. Surety Bond Guarantee (SBG) Program*

1. Staffing for the Office of Surety Bond Guarantees is proposed to be reduced to 10 FTEs in FY95 from its current staffing of 59.3 FTEs in FY94. What is the justification for such a drastic reduction in staffing?

Answer: The SBG program is another area where the SBA had to make some difficult decisions regarding the level of funding requested relative to the overall SBA budget ceilings.

This program has the ability to absorb staffing and funding reductions due to its relationship with Preferred Sureties. Our proposal assumes that this relationship is

dramatically enhanced, converting the traditional program to a full partnership with the Preferred Sureties. In doing so, the SBA would transfer the underwriting, claims and recovery processes to the Preferred Sureties, freeing up agency staff and resources.

2. How will the Administration maintain any form of field network for SBG Program delivery at these levels?

Answer: With a 100% Preferred Surety program, SBA's role would become primarily one of program policy development and oversight. This would minimize our need for a large field staff component.

3. With such reduced staffing, how could the Administration maintain the prior approval SBG Program through which 75 percent of the surety bonds will continue to be written even after a fully successful implementation of the preferred SBG Program?

Answer: The number of surety companies that are now participating in the Preferred Surety Bond (PSB) Program has far exceeded original expectations. When the PSB Program was implemented, it was anticipated that five standard companies would enter the program. Currently thirteen of the largest standard companies are participating in the PSB program. As a result of SBA's marketing efforts and outreach activities, the program is now recognized as a good resource for standard companies to extend bonding accessibility to small and minority contractors.

Under the preferred surety program, we have experienced a much lower loss rate than on our traditional program. In addition, we are able to reduce administrative costs due to their doing the underwriting, claims, and recovery processing.

Currently, preferred sureties are responsible for about 22% of our approval activity and we use about 59 FTEs to underwrite bonds, process claims, pursue recoveries, and provide program policy, oversight and monitoring of sureties. Because of the success of our preferred surety program, we propose to use these preferred sureties in FY 1995 to operate our entire \$1.8 billion surety bond program. These sureties would then be responsible for all underwriting and claims and recovery processing. This will relieve the SBA of these operations, allowing a reduction in FTEs to 10 to continue with program policy, oversight and monitoring.

If our proposed expansion of the preferred surety program is approved by the Congress, we would need to actively recruit additional sureties to participate in this program to provide full geographic coverage. We would assure that all sureties that currently participate in our regular program, big and small, have an opportunity to participate as preferred sureties.

#### QUESTIONS FROM SENATOR BOND

Several months ago, I wrote you inquiring about SBA funds being used to create and distribute a glossy pamphlet promoting the Clinton health care plan and its supposedly beneficial effects on small business. Do you believe this was an appropriate use of SBA funds, and have you made any effort to educate small business owners about the pros and cons of any of the other plans that have been put forward?

Answer: The health care brochure we printed was developed specifically for the purpose of educating small business owners. Clearly, health care is the number one issue facing small business owners today. All of the health care proposals that are out there are complicated. We felt it in the best interest of the small business community to use some of the money that we have in our budget for publications to educate and inform small business owners. We have every authority under the Small Business Act to provide such informational services.

When we discussed small business and health care at the hearings on your nomination, I remember you saying, "I do intend to be a staunch advocate for the needs of small business and the effect that any health care solution can have on small business. . .". You also said, speaking hypothetically in the context of adding 7 to 10 percent to the payroll costs of small business, that "clearly when you eat up 7 to 10 percent of the dollars of any organization, if you do not have any return for those dollars it certainly could have some adverse consequences." In light of these statements, do you believe that an employer mandate, as proposed by the Clinton administration, is the best way to finance health care? How severely impacted would small businesses be were an employer mandate to be imposed? If you have any objections, have you expressed them to the administration?

Answer: I do believe that building upon the current employer based system, as provided for in the Clinton health care reform plan, is in fact the best way to go for small business, because married with the other elements of the President's program, it will bring stability, predictability and fairness to the small business health care marketplace, none of which exist today. Because small businesses have no negotiating power in today's health care marketplace, they pay 35 percent more for health insurance than big business, and they are experiencing a rate of increase 50 percent higher. Universal coverage will eliminate the massive cost shifting that is partly responsible for the massive increase to small business, and an employer based system is necessary to achieve universal coverage.

I am glad to see the inclusion of a Low-Documentation Loans program, a pilot project to reduce dramatically the paperwork and time associated with applications for guaranty loans of \$100,000 or less. I was curious as to what, if any, other initiatives have been advanced to cut down on the burdensome paperwork associated with SBA loans, particularly in the context of natural disasters?

Answer: First let me note that we are moving rapidly forward with our review of the Low-Documentation Loan program and barring any unforeseen problems, we expect to move expeditiously to implement it nationwide.

With regard to our Disaster Loan program, we have, in fact, simplified our application procedures and significantly reduced our processing time. During the Midwest floods of 1993, SBA implemented a simplified disaster business loan application, the response to which has been extremely positive. In response to the Northridge, CA earthquake in January of this year, SBA expedited the implementation of a simplified home disaster loan application. SBA no longer asks applicants to provide proof of ownership and legal descriptions of the damaged property at the time of application; instead, they are submitted later after processing is already underway. Finally, SBA has implemented an agreement with the Internal Revenue Service to provide tax return information directly to SBA, thus eliminating the delay and hassle of disaster victims having to obtain copies of their returns.

#### QUESTIONS FROM SENATOR KOHL

(1) *Farmers.* In Wisconsin, and throughout the nation, our farm population is an aging population. Many of these elderly farmers are reluctant to make the capital investments necessary to modernize their operations. This is particularly true for capital intensive forms of agriculture like dairy.

Many of these farmers would like to retire, but haven't been able to put enough money aside to do so. To the extent that these farmers make any money at all, they reinvest it back in their farms. So in many cases their farms are their retirement.

I have a bill that would allow retiring farmers, when they sell their farms, to roll over the proceeds of the sale into - an IRA, instead of having to pay the lump-sum capital gains tax at the point of sale. *Could you comment on this, and state what role you see SBA playing in addressing this problem of the aging farm population?*

Answer: The proposal you raise, that of providing a mechanism whereby farmers can gain retirement benefits from reinvestment of profits from the sale of their farms, would undoubtedly be of benefit to many small family farmers. Without some further study, however, I don't feel that I can make a determination of the feasibility of the program. Like you, the SBA is very concerned with the problems facing rural America—for example, declining family ownership of small farms and a shrinking business sector that traditionally has supported farm communities. In order to support our rural communities, we are constantly looking at ways to insure that SBA resources are funneled into those areas where the need is greater. I look forward to looking with you to address the problems family farmers face.

(2) *International Trade.* At a time when U.S. markets in many industries are growing slowly, international trade can be key to the survival of small businesses, allowing them to increase sales and profit margins and discover huge new markets. Unfortunately, small businesses have traditionally shied away from international trade.

Given the new markets which will now be open to U.S. businesses under NAFTA and the recent GATT agreement, is SBA doing anything to help small businesses take advantage of these new opportunities?

Answer: Yes, SBA continues to provide information to small businesses about the North American free trade area. Approximately 60,000 copies of the SBA publication *Opportunity in Mexico: A Small Business Guide* have been distributed to inform U.S. businesses about trade with Mexico. As follow up to this pre-NAFTA publica-

tion, we also provide to businesses the Flash Facts numbers for Mexico and Canada. These Department of Commerce Flash Facts provide information by fax about these markets.

SBA is exploring a number of ways to better assist small businesses with its export finance programs. Exporters who need transactional financing for a single export sale or a series of like sales should find it easier with the improvements to SBA's export working capital program. As part of the President's National Export Strategy, SBA and the U.S. Export-Import Bank are joining together to offer a more customer-oriented program that can be accessed through SBA's over 100 field offices. In addition to making the program more flexible for borrowers, SBA hopes to make the program both easier to use and more profitable for lenders.

In April 1994, SBA will present a trade finance component at the REP COM trade show in Monterrey, Mexico, where 150 U.S. businesses are expected to attend. The businesses will also receive individualized trade finance counseling about Mexico, on the floor of the trade show.

SBA will continue offering medium- and long-term financing to exporters through its International Trade Loan (ITL) and Regular Business Loan programs. The ITL can support up to \$1 million for U.S.-based facilities and equipment used to expand export markets. The Regular Business Loan program can finance up to \$750 thousand for a variety of purposes, including general working capital, and U.S.-based land, buildings, equipment and machinery.

Export education and outreach continue to raise awareness of export-related benefits, and address the basic educational and training needs of export business start-ups and companies that have never before exported. Businesses which are unsure of how to get started in international trade benefit from the SBA's one-on-one counseling by Service Corps of Retired Executives volunteers and Small Business Development Centers with international trade subcenters.

More targeted, intensive assistance is available for small businesses that have some experience exporting or whose prospects for international market development are good. The U.S. Export Assistance Centers (USEACs) are geared towards helping businesses at all levels of experience.

All of these activities will help small businesses take advantage of the new opportunities in world markets due to the recent trade agreements.

I am interested in the Export Trade Assistance Centers you mentioned in your statement. You mentioned that you are planning to expand these centers around the country. I think it's an excellent idea and I'd like to see such a center in Milwaukee. I am already hearing about interest in the business community there. *What can we do to open one in Milwaukee?*

Answer: As you may know, this project has already been launched in Miami, Baltimore, Chicago and Los Angeles. During this first year of operation we will be adjusting and fine tuning programs and services offered by the USEACs to fit the needs and demands of the export communities they serve. Should the services of the USEACs prove to be as helpful to the business community as we believe they will be, we will consider opening an additional ten sites next year to expand this service.

The Trade Promotion Coordinating Committee (TPCC) Working Group on USEACs is developing criteria which will be used to determine future site selections. These are based on statistical data and agency resources. We will keep your request in mind when considering future site selections.

(3) *Health Care Reform.* As I'm sure you know, one of the greatest concerns for small businesses these days is health care costs and the discussions here in Washington about health care reform, especially about the possibility of being mandated to pay a portion of their employees' health insurance.

Frankly, some don't trust that the Clinton plan's subsidies will be there in the future—and that they'll be left holding the bag. Others don't trust that the government and alliances will be able to keep the plan's cap on business payroll costs from rising. What do you say to small businesses that tell you they are worried about trusting that the Clinton plan won't make things worse for them?

Answer: I tell them that things cannot get worse, which is also what small business owners across the country have been telling me for many months. Because small business has no negotiating power in today's health care marketplace, they pay 35 percent more for health insurance than big business, and they are experiencing a rate of increase 50 percent higher. Universal coverage will eliminate the massive cost shifting that is partly responsible for the massive increase to small business, and an employer mandate is necessary to achieve universal coverage.

Small business discounts will limit the impact on those businesses that currently do not offer health insurance, while many small firms will see a decrease in premi-

ums. In short, the President's health reform program will bring stability, predictability and fairness to the small business health care marketplace.



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